University of Alberta

Beer Wars: A Theoretical Examination of the Epistemic Community in the Canada-US Trade Disputes on Beer

by

Calvin L. Bricker

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A thesis submitted to the Faculty of Graduate Studies and research in partial fulfillment
of the requirements for the degree of Doctor of Philosophy

Department of Political Science

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The undersigned certify that they have read, and recommend to the Faculty of Graduate Studies and Research for acceptance, a thesis entitled *Beer Wars: A Theoretical Examination of the Epistemic Community in the Canada-US Trade Disputes on Beer* submitted by Calvin L. Bricker in partial fulfillment of the requirements for the degree of Doctor of Philosophy.

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Abstract

This dissertation seeks to assess whether the concept of epistemic communities provides a useful supplement to a statist explanation of events that occurred in the Canada-US beer wars. The Canada-US beer dispute began in the latter half of the 1980s and ended with the signing of a Memorandum of Understanding between Ottawa and Washington in 1993.

A review of the literature on Canadian foreign policy reveals that if theory is deployed at all in the literature, it tends to be the statist perspective. The position of this dissertation is that while the statist perspective tells analysts a great deal about how Canada's foreign policy decisions are ultimately derived, people and ideas are important determinants in this area of decision-making as well.

Such an approach hazards a number of formidable ontological, epistemological and methodological barriers that lie at the core of the 'inter-paradigm' debate in the literature on international relations. To help overcome some of these hurdles, this dissertation employs an approach characterized in international relations literature as methodological pluralism.

The statist focus on rational calculations of material interests is advanced as the null hypothesis in this examination. Should the null hypothesis prove inadequate to explain events, it will be supplemented by two further hypotheses designed to test the efficacy of an epistemic communities' explanation. These hypotheses are, first, that an epistemic community comprised of trade officials from Canada's Department of Foreign Affairs and International Trade and the Office of the United States Trade

Representative was operating during this dispute; and second, this epistemic community had a determinative impact on the dispute's outcome.

Following a brief examination of the brewing industries' development in Canada and the United States, as well as the regulatory practices of both countries, the hypotheses are deployed to examine the events of the disputes launched, first by the European Economic Community, and then, the US, under the trade dispute settlement provisions of the GATT, over the commercial practices of Canada's provincial liquor boards.

The dissertation concludes that the epistemic community was a key driver of events when it was permitted the 'political space' by elected officials.

Acknowledgments

This dissertation represents a journey that began in 1984 at York University in Toronto. Any quest that takes close to twenty years has no doubt touched many waypoints and people along the way. It is important that they all know how critical their assistance has been to the completion of this project.

First, I must acknowledge my wife, Lisa Pomerant, and my wonderful children Joseph and Cole. They have endured more than any family should ever have to in helping me to fulfill my dream. There were many missed events, holidays and special occasions where I was either absent physically, or was in another place mentally. Despite this, their support buoyed me always. I could not have done it without them. And, I hope that, if nothing else, the benefit imparted to my two boys in return is that it is critical in life to finish what you have started, no matter how long it takes.

Next, the support of my mother and father, Irene and Wayne Bricker, and my in-laws, Phyllis and Lou Gordon, is critical to acknowledge. They've all known how important it was for me to close the door that I left ajar so long ago. They have been there always to help any way that they could to ensure that Lisa, the boys and I had all the support we needed to complete this project.

I'd also like to acknowledge the support of my supervisor, Dr. Andy Knight. We've known each other close to twenty years, through the many changes and challenges that a period of that duration can bring. Dr. Knight has been a friend, guide and inspiration to me throughout this effort. I can only hope that if I am ever asked by a student to help steer them through a project like this that I can measure up to the standard set by Dr. Knight.

Lastly, I'd like to thank two individuals for providing me additional inspiration to see this through to the finish line. First, my original Ph.D dissertation supervisor was Dr. Rod Byers of York University. Shortly after I began what was at that time a different dissertation focused on another subject matter entirely, Dr. Byers contracted cancer. He passed away soon after. I recall a conversation I had with him a month or two before he lost the battle that he had fought so courageously. He asked that I make sure that I finish the Ph.D for him. That request has stayed with me over these many years, and I've thought about it often when I felt that my obligations to family, work and this project were becoming too heavy. I hope he is pleased with the result.

Second, I'd like to thank my wife Lisa's grandmother, Esther Wolfond. When I first met her I was a twenty-five year old Ph.D student at York University, and she was seventy-three years old. Not a year has gone by that she has not asked me, on any number of occasions, whether I was planning on finishing because she wasn't getting any younger. Well, she's ninety now and still asking. Finally, I can give her the answer she was looking for.

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Introduction

Overview

Intuition is the wellspring of most academic analyses. A real world event happens that does not seem to fit with existing explanations. Curious analysts play hunches to see how to account for it.

If the analyst happens to be an academic, the point of departure for explaining events tends to be the existing theoretical literature. Academics often deploy known theories to test their explanatory efficacy against new facts. If found wanting, a chosen theory is either modified to encompass the new circumstances, or it is dispensed with altogether. An alternative explanation is then advanced to take its place.

This study contemplates undertaking an exploration of this sort. The real world events that will be examined are the Canada-US beer disputes that began in the late 1980s, and continued on into the mid-1990s when they ended with the framing of a Memorandum of Understanding between Canada and the United States in the late summer of 1993.

The theory used to examine these events is the 'statist' perspective. The statist theoretical standpoint has a wide following in Canadian foreign policy literature. Statist theory shares an ontological space with 'realism' in the broader international relations (IR) literature. It assumes that states are unitary rational actors that make decisions based on rational calculations of expected utility.

The weighing of costs and benefits contemplated by the statist perspective can explain many of the decisions made by Washington and Ottawa in their clash over beer. However, there are a number of critical events that occurred in the Canada-US beer dispute that cannot be explained by summing utilities. An accurate explanation of these events calls for the statist perspective to be supplemented by other theoretical approaches.

As the case study on the Canada-US beer dispute unfolds, it will become clear that factors like people and ideas had a significant impact on decision-making in both Washington and Ottawa. Statism is ill suited for gauging the impact of these variables on foreign policy decision-making. The epistemic community perspective is better matched to this purpose.

An epistemic community is a group of 'experts' who share ideas and beliefs, as well as a commitment to a common policy project that they press on state decision-makers and others under conditions of uncertainty. By virtue of their status as experts, members of epistemic communities are able to help define the terms of policy debate and participate in filtering evidence to be weighed in foreign policy deliberations. In doing so, epistemic communities influence the policy development process both within, and between states.

The position developed in this dissertation is that while rational calculations of expected utility drove many of the decisions made by Ottawa and Washington during the Canada-US beer disputes, an epistemic community comprised of trade experts in Canada's Department of Foreign Affairs and International Trade and the Office of the United States Trade Representative exerted an enormous influence on events. This was particularly the case when these trade experts were provided 'political space' by elected officials and were essentially permitted to manage the dispute.

Framework for Analysis

Chapter 1 begins with an examination of the literature on Canadian foreign policy. The statist perspective emerges as 'normal science' in this literature.[1] The position is advanced that the statist theoretical view could potentially be improved upon or displaced if it were subjected to the challenges that its analog – realism – is facing in the broader literature on international relations. Statism and realism share a number of important theoretical dimensions, including a common ontological core and an affinity for the epistemology and methods of positivist social science.

To trace the tests that realism is currently facing on ontology, epistemology and methodology in IR literature, the analysis shifts to focus on the debate between the rationalist/problem-solving and critical/reflective perspectives. Emerging from this dialogue are a number of approaches that show promise in terms of bridging enduring divides in the discipline. One of these is the epistemic community perspective.

Chapter 2 is devoted to examining the origins and development of the epistemic community concept. The chapter begins with a review of the literature on the impact of ideas in foreign policy. The epistemic community perspective seeks to take critical/reflective notions embodied in the role of ideas and shared intersubjectivities and examine them via the positivist research method of the rationalist/problem-solving perspective. This is accomplished by identifying specific epistemic communities, isolating their shared intersubjectivities, and tracing the impact of community members on foreign policy decision-making processes. These methods are employed in the case study section of this dissertation to determine if there was indeed an epistemic community operating during the period of the Canada-US beer disputes, and to identify what impact, if any, this epistemic community had on events.

---

[1] Thomas Kuhn (Kuhn 1970 p. 10) defines 'normal science' as: "… research firmly based upon one or more past scientific achievements, achievements that some particular scientific community acknowledges for a time as supplying the foundation for its further practice." Kuhn goes on to say that (Kuhn 1970 p. 11): "Men whose research is based on shared paradigms are committed to the same rules and standards for scientific practice. That commitment and the apparent consensus it produces are prerequisites for normal science, i.e., for the genesis and continuation of a particular research tradition."

The third chapter addresses methodology. The methodological approach employed is best captured by what Goldstein and Keohane refer to as 'methodological pluralism.' Methodological pluralism seeks to maintain the hypothesis testing methods of positivist social science while also embracing the interpretive ones favoured by reflectivist/critical approaches. This chapter also sets out the hypotheses that are tested in the dissertation. Following on the advice of Goldstein and Keohane that gauging the impact of ideas on foreign policy decision-making requires that explanations relying on rational calculations of the material interests at stake be taken seriously, the first hypothesis to be tested is that the events of the Canada-US beer dispute can be explained primarily by considering rational calculations about the material interests at play for Canada and the United States. If this hypothesis cannot explain events on its own, two alternative hypotheses intended to test the efficacy of the epistemic community approach will be examined. They are, first, that an epistemic community comprised of trade officials from DFAIT and the USTR was operating during the Canada-US beer dispute; and second, that this epistemic community had an impact on policy outcomes in the Canada-US beer dispute. Chapter 3 also discusses the sources used to conduct this analysis, and further lists the questions asked of various individuals interviewed during the course of the research.

Chapter four seeks to locate the Canada-US beer dispute in an historical context. This involves tracing the historical development of the Canadian and US beer industries as well as comparing and contrasting the regulatory environments governing alcoholic beverages in the two countries. Regulations have played an essential role in determining the structure of the brewing industry in both Canada and the United States. It is in the differences between these two regulatory environments that the seeds were sown for the Canada-US beer disputes.

The fifth chapter commence the review of the trade disputes over the practices of Canada's provincial liquor boards. These trade disputes followed two tracks. The first, where liquor board practices governing wine and spirits were the focus and beer was a secondary concern, was the European track. The second, Canada-US track, involved both bilateral and multilateral dispute settlement and negotiations. This chapter deals primarily with the European track and the nascent stages of the US track, which was to play out in the CUSTA (Canada-US Trade Agreement) and the GATT.[2]

Chapter 6 begins with the initial response of Canada's brewers to the EC Panel Report and the CUSTA. It then shifts to discussing the Ontario government's reaction to the growth of US imports, which led to the initiation of a trade action by US brewers that in turn triggered the clash between Canada and the US on provincial liquor board practices.

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[2] General Agreement on Tariffs and Trade. *Basic Instruments and Selected Documents. Volume IV.* Geneva: The Contracting Parties to the General Agreement on Tariffs and Trade. 1969.

The seventh chapter reviews the period from the initiation of the US trade action to the findings of what is known to participants in the beer dispute as the Beer 1 GATT Panel Report. Highlights of this period include the responses of Washington and Ottawa to the report, as well as the various activities of the many stakeholder groups involved in the dispute.

Chapter 8 concludes the case study section and covers the final phase of the Canada-US beer dispute. It begins with an examination of the pre-negotiation maneuvering of Canada and the US to settle the Beer 1 Panel Report and moves on to discuss the US decision to retaliate against Canada, and Canada's counter-retaliation against US beer imports into Ontario. The examination then shifts to describing the bilateral talks that led to the framing of the Memorandum of Understanding (MOU) that settled the Canada-US beer dispute.

The dissertation concludes with a discussion of the aftermath of the MOU, including its impact on the various stakeholders in Canada and the US. Additionally, an assessment of the efficacy of the hypotheses used to explain events is provided. The statist hypothesis is shown to be well suited to illuminate much of what occurred during the Canada-US beer dispute, particularly how the dispute began and ended.

However, though the beginning and the end of the Canada-US beer dispute are amenable to a statist explanation, much went on in between that does not square with rational calculations about the expected utilities at stake for Canada and the United States. The judgment is made that these anomalies are better suited to an epistemic community explanation, which brings to the fore the importance of shared ideas between trade officials in Canada and the United States. A review of these shared ideas and how they affected events is provided.

The conclusion discusses the nature of the original contribution provided by this dissertation and also outlines some prospects for future research, particularly in terms of applying the epistemic community approach to other trade disputes between Canada and the United States.

Chapter One

Literature Review

Canadian Foreign Policy Literature

In surveying the literature on Canadian foreign policy, one is struck by the enormous volume of work produced by a country with a population of approximately thirty million people and a history of only 136 years as an independent state.

The interest of Canadians in studying their country's role in the world can be attributed to many factors. For example, the impact on the lives of ordinary Canadians of globalization, including the burgeoning number of international institutions, both formal and informal, designed to manage issues ranging from trade to security and human rights, has led to increasing curiosity in a number of quarters about Canada's place in international affairs. Moreover, ubiquitous and instantaneous coverage by news media (and, for many Canadians, this is U.S. television news) of international politics, the escalating growth of international travel and the proliferation of magazines and journals related to international issues has given rise to increasing interest amongst Canadians about international issues.

Wherever there is a palpable "real world" impact on the lives of Canadians, the attention of Canada's government officials and scholars usually follows. Contributions resulting from the efforts of both Canadian scholars and diplomats to examine Canada's international relations have on occasion received acclaim from beyond Canada's borders. On the political level, Prime Ministers Lester Pearson, Pierre Trudeau and Brian Mulroney, and, bureaucratic officials such as Norman Robertson, Hume Wrong, Maurice Strong, Ivan Head, Allan Gotlieb, Derek Burney, Lloyd Axworthy, Stephen Lewis and John Humphrey have all been recognized for their wisdom and impact on international affairs. From the academy, James Earys, Stephen Clarkson, Andy Cooper, John Holmes, Rod Byers, Denis Stairs, Janice Gross Stein, David Dewitt, John Kirton, Kim Nossal, Tom Keating, Andy Knight, Robert Cox and many others have had a significant impact on thinking about the subject of Canada's role in the world, as well as international relations scholarship generally.

While one would expect academics to analyze Canada's activities in the world, a number of politicians and bureaucratic officials have also contributed to the literature. In evaluating this literature from the standpoint of theory, it is surprisingly difficult to distinguish whether the author came from a university faculty or from Ottawa's Lester Pearson Building, the home of Canada's Department of Foreign Affairs and International Trade (DFAIT). This is at least partially attributable to the prominence of the 'statist' theoretical position held by both academics and foreign policy practitioners in Canada.

Statism[3], which shares "realism's[4]" ontological foundation,[5] considers states as relatively autonomous, rational utility maximizers interacting with similarly self-regarding entities in the international system. Realists, particularly neorealists, view the state *qua* state as the primary unit of analysis in international politics. Statists share this perspective. However, consistent with more traditional realists, they also regard the state as less a "billiard ball" than a forum within which lively debate amongst decision-makers[6] and interested stakeholders takes place to frame a Canadian 'national interest' that is then projected abroad.

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[3] Krasner (1978 pp. 5-6) provides a parsimonious definition of the statist perspective: "A statist paradigm views the state as an autonomous actor. The objectives sought by the state cannot be reduced to some summation of private desires. These objectives can be called appropriately the national interest." The issue of what constitutes the "national interest" is an important one. For realists, it is usually not problematized – but assumed. For Marxists and others it is derived from the structure of either class or power inherent in the international system. Krasner (1978: p. 13) suggests a different perspective in which the national interest is: "… [T]he preferences of … central decision-makers. Such a set of objectives must be related to general societal goals, persist over time, and have a consistent ranking of importance in order to justify using the term 'national interest." This definition problematizes the concept of national interest and suggests its linkage to preferences emanating from civil society. This latter point is problematic given the microeconomic methodology that Krasner employs in his book. Microeconomics is at best capable of imputing motives and preferences from outcomes. An analogy is one's reaction to a loud noise heard while walking in the woods. You assume that it is a tree falling. But, this is only a guess based on the outcome – not, on direct observation of the real cause. Cox (1996: p. 56) offers a further critique of this view of national interest suggesting that it is difficult "… to distinguish a national interest from the welter of particular interests, if they mean that such a general will exists as some form of objective reality."

[4] The linkage to realism and its agenda for study is drawn by Nossal (1997 p. 5). It is consistent with the "high politics" agenda of realist scholars like Hobbes, E.H. Carr, Morgenthau, Gilpin, Tucker, Kissinger, Waltz and others. An appraisal of this literature, which includes excerpts from each of these writers, is presented in Viotti and Kauppi (1987). Marxist scholars also have an interest in the state and how it operates in international relations. As Krasner (1978 p. xii) notes, a survey of Poulantzas, Miliband, Habermas and O'Conner reveals lively debate on the role of the state in international relations – though, of course, from very different ontological and epistemological positions.

[5] The "liberal internationalist" tradition in Canadian foreign policy also embraces statism. While there is clearly an important difference between what Keating (quoted in Molot, 1990 pp. 80-81) describes as 'the Grotian perspective on the nature of international politics' held by some liberal institutionalists, and Realism, it is on normative grounds and emphasis rather than ontology or epistemology.

[6] On endogenous influences on the state, Black and Smith (1993 p. 749) note that: "Analysts adopting this [statist] approach, usually implicitly, view the state as having a substantial degree of autonomy from civil society. Nevertheless, it is subject to societal influence in a very broad sense …." This perspective is elaborated in greater detail by Nossal (1997 p. 12). It is in the need to look into what Waltz has called the 'second image or within the state itself – that the statist perspective treads on less firm ground. This has resulted in a number of challenges, principally because statism has difficulty incorporating interests, norms and beliefs in its analysis. To address this shortcoming, some statist analysts have employed the 'bureaucratic politics' approach (see: Allison 1971; Atkinson and Nossal 1979 and Nossal 1981).

Consequently, endogenous influences on policy outcomes are examined in many personal reflections[7] and academic analyses in the statist tradition of Canadian foreign policy literature. These analyses feature rich histories of the personalities and institutions that affect Canadian foreign policy-making.

While the importance of interactions between and amongst individuals and institutions is acknowledged by statists as an important influence on the foreign policy-making process, the perspective also holds that the principal levers of decision-making rest ultimately with the "state" – or, specifically, Canada's federal government, with the Prime Minister at its head.[8] In matters of foreign policy,[9] the trump card features in Ottawa's hand.[10]

Though Canada's federal government steers the country's foreign policy in most respects, its mandate to do so is based less on explicit constitutional authority than on historically accepted practice. Neither the British North America Act of 1867 nor the Constitution Act of 1982 provides plain direction on which level of government – Canada's federal government or the provinces – has a mandate to control many important aspects of Canada's foreign policy. This imprecision has led to frequent constitutional wrangling on where the line of federal control should properly be drawn on such matters as, for example, requiring the provinces to abide by Canada's international treaty obligations in areas where provincial governments are directed by the constitution to govern.

This is an important point as it relates to federal obligations under treaties like the General Agreement on Tariffs and Trade (GATT) where Ottawa is required, under

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[7] Contemporary personal reflections include: Allan Gotlieb (1991); Ivan Head and Pierre Trudeau (1995); and Gordon Ritchie (1997).

[8] Nossal (1997 p. 176) describes the Prime Minister's control over foreign policy, and other matters of state decision-making, in the following passage: "The enduring traditions of the Westminster model have it that the Prime Minister is, as a member of a collegial collective, only *primus inter pares*. In fact the Prime Minister occupies a central and commanding position in Canadian politics. It is true that a Prime Minister's freedom of action may be constrained by numerous factors. Statute and constitutional provisions may pose limits, and so, too, may convention, such as the federal principle in cabinet-making. But within these parameters, a Prime Minister's prerogative is sweeping. As a result, each Prime Minister has demonstrated a clear pre-eminence in policy-making and has inevitably left a personal mark on national policy and politics."

[9] 'Pluralist' statist analysis acknowledges the importance of influences from sources like the provinces, business groups, church groups, academics and others, on the policy-making process. For example, Nossal's book features a chapter on the emerging importance of Quebec in Canadian foreign policy.

[10] Nossal (1997 p. 176) expands on this point: "However anachronistic the symbols of governance in Canada may appear to be, the formal authority for the conduct of foreign policy is nonetheless an important exercise. For it explains why foreign policy decision-making in Canada is properly the responsibility of the political executive alone. It explains why the other institutions of governance, notably the legislature and the judiciary, have little role in the shaping of external policy. It also explains why the focus of a study of foreign policy must inescapably be on the cabinet and, in particular, on that central core of ministers most heavily involved in foreign policy decision-making. Depending on the issue, that circle may include the minister of national defence, the minister of finance, the minister for international trade, or one or both of the secretaries of state. But, on important issues, the Prime Minister will likely be at the centre."

Sec. XXIV:12 to take "reasonable efforts" to assure compliance by subnational governments. With the ambiguity of Canada's jurisprudence in this area,[11] it is unclear where the rights and obligations for making foreign policy in areas of provincial jurisdiction lie. This matter was central to the deliberations between Ottawa and the provinces during the disputes on beer and it is an issue that will be engaged in the case study that follows in this dissertation.

The statist perspective is clearly at the core of an important examination of Canadian foreign policy; Kim Nossal's text, *The Politics of Canadian Foreign Policy*. Nossal consciously employs the statist approach, setting out in his "Note to Students" that:

> The focus of this book is traditionally state-centric: its purpose is to explain the foreign policy decisions of the state, and not the many other actors who crowd the world stage.[12]

He proceeds to set out a traditional, parsimonious and policy relevant[13] examination of Canadian foreign policy-making. Nossal focuses on topics such as Canada's place in the world[14] and the roles of the Prime Minister and DFAIT.

To analysts who would challenge Nossal's views on theoretical grounds, he answers:

> I offer no apology for the absence of [other] perspectives.... A book on Canadian foreign policy using an international political economy, a post-modern, or a gender-analysis approach would require a different book – one that asked substantially different questions and employed fundamentally different assumptions. In short, these are not approaches that one can merely "add" to a traditional approach and stir – at least not if one wishes to do them justice. Rather, these are approaches that require a (re) construction of the project *de novo*.[15]

---

[11] Examples include: *Regulation and Control of Aeronautics in Canada.*, [1932] A.C. 54, [1931] 3 W.W.B. 625, 39 C.R.C. 108 [1932] 1 D.L.R. (P.C.); *Regulation and Control of Radio Communication in Canada., Re (Radio Preference)* [1932] A.C. 304, 1 W.W.R. 563, 39 C.R.C. 49, [1932] D.L.R. 81 (P.C.); and *A.-G. Can. v. A.-G. Ont. (Labour Conventions)* [1937] A.C. 326, [1937] 1 W.W.R. 299, [1937] 1 D.L.R. 673 (P.C.).

[12] Nossal (1997 p. xiv).

[13] Policy relevance is a key focus of the statist perspective. As Molot (1990 p. 78) acknowledges: "...[A]... major theme or organizing principle of Canadian foreign policy literature is policy formulation – that which investigates the way in which Canadian foreign policy is made and the role of institutions – governmental and non-governmental – in the process."

[14] This concern with "Canada's place in the world" is cited by Molot (1990 p.77).

[15] Nossal (1997 p. xv).

Nossal's challenge is a provocative one, and it is at least partly in answer to a number of critiques that have appeared protesting the paucity of theoretical exploration in the literature on Canada's role in the world.[16]

For example, Michael Hawes has criticized the statist approach to studying Canadian foreign policy. In reviewing the theoretical literature on Canadian foreign policy, he observes that:[17]

> "... [O]ne is immediately struck by its conceptual and theoretical failings. Indeed, despite a number of notable exceptions, much of the literature is predominantly issue-oriented; the tendency has been to describe rather than to analyze.[18]

As examples of 'notable exceptions' Hawes points to the complex neorealism work of Dewitt and Kirton,[19] the challenges of Cranford Pratt[20] on "dominant class theory," followed by Neufeld and others,[21] and Robert Cox's "historical materialist[22]" provocation.

Despite these efforts at opening the theoretical aperture to examine issues in Canadian foreign policy in less traditional ways, Black and Smith point out that it remains the case that:

> "...[T]he theoretical development of Canadian Foreign Policy is marked by significant inadequacies and lacunae. Above all there is, at best, limited cumulation: limited refinement of promising theoretical beginnings, limited pursuit of interesting debates and limited empirical research designed to test and refine theoretical and analytical propositions.[23]

Why? Black and Smith propose an explanation that focuses on three factors:

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[16] Nossal (1997 p. xiv).

[17] Hawes (1984), borrowing from the work of scholars like James Earys and Dewitt and Kirton, suggested that there were three contending theories in the literature that position Canada as either a "middle power, principal power or satellite."

[18] Hawes (1984 p. 2).

[19] See Dewitt and Kirton (1983). Black and Smith, (1993 p. 758) acknowledge their efforts at theoretical analysis: "... [T]hey should be given credit for their efforts to incorporate international relations theory into the study of Canadian foreign policy. They recognize that Canadian foreign policy is not simply an output into an inert international system. More importantly, they assert that we must, of necessity, have a clear theoretical understanding of that system."

[20] See Cranford Pratt (1983-84).

[21] See Neufeld (1995) and Neufeld and Whitworth (1997).

[22] See Cox (1983, 1987, 1989, and 1991).

[23] Black and Smith (1993 p. 746).

1. A lack of scholars working in the field;
2. Cultural aspects that are peculiar to Canadian academics;[24] and
3. Institutional issues, particularly as they relate to how funding is allocated for research on Canadian foreign policy.[25]

All of these factors have probably contributed to a relative lack of theoretical enquiry in the literature on Canadian foreign policy. However, they are only symptomatic of a larger issue that operates to discourage theoretical challenges to statism. That issue is that statism's key tenets enjoy the status of "common sense" amongst most of the community that analyzes, writes about and participates in Canadian foreign policy-making.

The use of "common sense" in this context refers to a view that the explanations statism provides for events occurring in the "real world" are sufficient for the purposes of accurate reporting and policy prescription. This is not unlike the claims of "common sense" asserted for Realism, which guides most enquiries in the broader field of international relations. In both instances, the perspective's core assumptions are generally uncontested. Analysis focuses instead on considering case studies driven by a desire to generate data relevant for policy-making discussions.[26]

Why is this a problem? If there is a parsimonious explanation available that is widely agreed and policy relevant, should there be a need to employ something else?

The answer to this question is rooted in the pivotal role that theory plays in establishing what gets studied. The waypoints touched in any analytical excursion are established by the theory an analyst has in mind on embarkation. To each student, academic, commentator, government official or interested citizen, the theory employed limits the scope of enquiry. Depending on the viewpoint adopted, some issues will be examined and other potentially important matters eschewed. In any exercise focussed on understanding and explaining, this is a fact that, first, must be acknowledged, and then, examined.

Steve Smith takes up the importance of 'common sense' and its effect on theoretical enquiry, as well as its impact on real-world choices that are made.[27] Smith suggests that international theory is inexorably linked to international practice. Once theories are established as 'common sense', they suggest not only what can be known but also what is sensible to examine and debate. Straying beyond the ambit of common sense places analysts outside the mainstream of enquiry, which can limit their participation in the foreign policy debate.

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[24] Black and Smith (1993 p. 768).

[25] Black and Smith (1993 pp. 768-69).

[26] Cox (in Cox with Sinclair 1996 p. 9) discusses common sense in terms of ontology. He notes that: "Ontologies are not arbitrary constructions; they are the specification of the common sense of an epoch."

[27] Steve Smith in Smith, Booth and Zalewski (1996 p. 135). Smith goes on to say that: "Defining common sense is therefore the ultimate act of political power. In this sense what is at stake in debates about epistemology is very significant for political practice. Theories do not simply explain or predict, they tell us what possibilities exist for human action and intervention; they define not merely our explanatory possibilities but also our ethical and practical horizons."

In a challenge to 'common sense' assertions, Black and Smith propose that for the literature on Canadian foreign policy to advance in theoretical terms, Statism must be tested to assess its explanatory validity.[28] To do so, they advocate tapping into the literature on international relations theory for clues as to potentially fruitful avenues of enquiry.[29]

This strategy is a sensible one given the large degree of overlap between the literatures on Canadian foreign policy and international relations. Additionally, a recent focus in IR literature has been to test the 'common sense' status granted Realism by its proponents. Of the many challenges mounted, which include, *inter alia*, historicism, Marxism, Gramscianism, gender, and others, the most instructive for the purposes of this enquiry is a recent venture to assess and, in some instances, move beyond, the enduring divide between 'rationalism and reflectivism,' or 'problem-solving and critical theory.' It is to an assessment of this literature that analysis now turns.

International Relations Theory

The literature on IR theory has been reviewed in many texts.[30] The purpose of this discussion is less to enumerate the nuances of wide-ranging debates in IR literature than it is to uncover new analytical possibilities for examining the Canada-US beer wars beyond those contemplated by statist analysis.

This is not to say that a statist examination could not provide a satisfactory explanation of issues in the Canada-US beer wars on its own. That possibility exists and will be examined. However, a determination cannot be made on the potential utility of other theoretical standpoints unless they are deployed and assessed. For the purposes of this dissertation, the appraisal will be conducted using the Canada-US beer wars as a case study.

What is theory?[31] Robert Cox offers a compelling perspective focussing both on what theory is, and what it is not. To Cox:

> Theory is not absolute knowledge, not a final revelation or a completeness of rational knowledge

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[28] Black and Smith (1993 pp. 772-73).

[29] Black and Smith (1993 p. 773) suggest that historical materialism, regime theory and epistemic communities literature merit examination.

[30] Comprehensive reviews include: Maghoori and Ramberg (1982); Holsti (1985); Viotti and Kauppi (1987); Rosenau (1993).

[31] If IR theory represents a large body of work – it is small in comparison to the multi-disciplinary efforts focused on examining social science theory. Again, it is not the purpose of this analysis to examine this literature in any detail beyond what can assist gauging the adequacy of the Statist perspective in explaining the beer wars. For a fuller engagement of this question, see: Kuhn (1970).

> about the laws of history. It is a set of viable working hypotheses. It is a form of knowledge that transcends the specific historical epoch that makes the epoch intelligible in a larger perspective – not the perspective of eternity, which stands outside of history, but the perspective of a long sweep of history.[32]

Of the many important facets of Cox's definition, two stand out in terms of considering the common sense status granted 'Statism' in the literature on Canadian foreign policy and 'Realism' in the mainstream literature on IR. The first is that theory is an imperfect, unending work in progress. Secondly, a theoretical perspective must reflect the historical conditions of the period it is intended to explain while at the same time demonstrating the potential for transcending them. So, theory must be not only a product of its times, it also must withstand iteration.[33] If it is to endure, theory ought to be both adaptable and resilient.[34]

That both Statism and Realism meet Cox's test is evidenced by their continuing dominance over the literature on Canadian foreign policy and international relations respectively. However, this dominance should not simply be accepted with the only work left to analysts being the 'bolting-on' of an assortment of case studies. The 'viable working hypotheses' of Realism and Statism must also be put to the test and be either modified or discarded based on their relative fit with specific historical conditions and the case data at hand. If there is a perceived lack of fit, another theoretical avenue should then be explored. If there is another disconnect, something else should be tried. And, so on. It is via this kind of effort that theory can evolve.

Exercises like this have been undertaken more frequently and had greater resonance for Realism in IR literature than for Statism in writings on Canadian foreign policy. Consequently, a review of recent debates on the salience of Realism in the literature on IR may suggest analytical counterpoints to the Statist perspective in Canadian foreign policy literature worth exploring.

There have been at least three significant debates in the literature on international relations.[35] The most recent, and also the most relevant for the purposes of this analysis, is the 'inter-paradigm debate'.[36]

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[32] Cox in Rosenau and Cziempel (1992 p. 135).

[33] See Kuhn (1970) for the most influential explication of how theories evolve in the social sciences.

[34] For example, according to Dewitt and Kirton (1983 pp. 2-3), the lack of "fit" between contending perspectives in Canadian foreign policy writing, which they describe as "the debate between those who see Canada as an internationalist middle power and those who view it as a dependent satellite," and real world events, is what prompted them to develop the 'complex neorealism' perspective.

[35] See: Maghoori and Ramberg (1982); Holsti (1985); Viotti and Kauppi (1987); Rosenau (1993) for reviews of the debates in IR theory.

[36] Some theorists question the validity of the 'inter-paradigm debate'. For example, Waever in Smith, Booth and Zalewski (1996 p. 149) questions: "Did it exist, the inter-paradigm debate? Partly no, it was not actually an intense three-way debate occupying the minds of International Relationists, but an artificially constructed 'debate,' mainly invented for specific presentational purposes, teaching a self-

The inter-paradigm debate features three contending worldviews. They are, in Viotti and Kauppi's assessment of the literature, Realism, Pluralism and Globalism.[37] Waever suggests that these viewpoints coincide closely with contending themes evident in most theoretical discourse in the social sciences – conservatism, liberalism and radicalism,[38] though it is certainly debatable whether 'globalism' and 'radicalism' are as closely aligned as the other two traditions.

The resilience of three theoretical impulses in the IR literature suggests that their core propositions and differences have an enduring resonance. However, events and evolution in critical thought have occasionally narrowed these distinctions. It is along these lines that the inter-paradigm debate has been redrawn recently.

The axis for change is, in the view of Ruggie, between the 'neo' variants of realism[39] and liberal institutionalism.[40] The positions are converging,[41] and the result, he contends, is a 'neo-neo' synthesis.[42]

Ruggie suggests that the 'neo' variants of realism and liberal institutionalism share an ontological core casting states as self-reliant utility maximizers responding virtually exclusively to calculations of assumed material interest.[43] Additionally, these two impulses share an epistemological commitment to 'positivism.'

Positivism,[44] an approach to theoretical enquiry rooted in empiricism and naturalism, suggests to analysts a series of assumptions and commitments on ontology,

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reflection of the discipline.... Partly yes, it refers to a pattern of behaviour and an attitude which gradually emerged in the 1970s and was given a clarifying label as the 'inter-paradigm debate'."

[37] For a description of the evolution of each perspective, see Viotti and Kauppi (1987).

[38] Waever in Smith, Booth and Zalewski (1996 p. 172)

[39] The principal architect of the 'neorealist' impulse in IR theory has been Kenneth Waltz (1979).

[40] The neoliberal institutionalist mission is described by Cornett and Caporaso in Rosenau and Cziempel (1992 p. 233): "Neoliberal institutionalists seek to explain how international institutions may temper the effects of anarchy by independently altering the costs and benefits of cooperation."

[41] Ole Waever in Smith, Booth and Zalewski (1996 p. 164) suggests that work falling into what he calls the 'neo-neo synthesis' is: "Regime theory, co-operation under anarchy, hegemonic stability, alliance theory, trade negotiations, and Buzanian security analysis ...."

[42] The term 'neo-neo' synthesis is coined by Ole Waever in Smith, Booth and Zalewski (1996).

[43] Ruggie (1998 p. 3). Chekel (1998 p. 327) also notes that: "Scholars of rational choice ... use a behavioural model based on utility maximization: when confronted with various options, an agent picks the one that best serves its objectives and interests. Much rational choice research (thick rationalism) also makes assumptions about the content of these interests, typically that they are material goods such as power or wealth. State (agent) interests are given a priori and exogenously. Norms and social structures at most constrain the choices and behaviour of self-interested states, which operate according to a logic of consequences (means-ends calculations.)."

[44] Cox (1996 p. 51) offers the following definition of positivism: "By 'positivism' I mean the effort to conceive social science on the model of physics (or more particularly, physics as it was known in the eighteenth and nineteenth centuries, before it had assimilated the principles of relativity and uncertainty). This involves positing a separation of subject and object. The data of politics are externally perceived events brought about by the interaction of actors in a field. The field itself, being an arrangement of actors, has certain properties of its own which can be called 'systemic.' The concept of 'cause' is applicable within such a framework of forces. Powerful actors are 'causes' of

epistemology and methodology.[45] Key among these is the de-limiting of social phenomena to specific variables for the purposes of identifying causal relationships that can be generalized across cases. A joint commitment to positivism and a narrowing consensus on key causal variables has operated to ratchet together neo-realist and liberal institutionalist analyses.[46]

This conjoining of perspectives is evidenced by, for example, the 'neo-neo synthesis' viewpoint on institutions. Both neo-realist and liberal institutionalist analyses account for institutions in largely instrumental terms.[47] Institutions serve a purpose that rational utility maximizing states accept and defer to as long as the conditions that brought them together inhere. If circumstances change and an institutional arrangement no longer meets a state's needs, the self-utility maximizing entity elects rationally to either play a dominating strategy or work with its neighbours to evolve the institution to better meet the new assessment of how to advance its material interests.

Positivist enquiry is particularly well suited to illuminating variables affecting the rise and fall of institutions cast as outcomes of rational utility calculations. As could be expected in any analysis focused on isolating and proving 'if-then' propositions, the methodologies employed are closely related to microeconomics[48] – though there are variations for neorealists and neoliberal institutionalists. For neorealists, it is "... the microeconomic model of the formation of markets transposed into the international realm,"[49]as first articulated by Kenneth Waltz.[50] For neoliberal institutionalists, the microeconomic model has a slightly different cant, with a focus on market failure.[51]

Ruggie critiques the neo-neo approach on institutions by suggesting that there is more to comprehending their formation, evolution or dissolution than parsing a utility calculation can capture. To grasp the essence of an institution and its impact on world politics it is necessary to appreciate that at its core lies a 'shared intersubjectivity' binding it together.[52] Accounting for how institutions are created,

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change in the behaviour of less powerful ones, and the structure of the system 'causes' certain forms of behaviour on the part of the actors."

[45] Buzan in Smith, Booth and Zalewski (1996 p. 54)

[46] Ruggie (1998 p. 10) contends that the current debate " ... is barely a fair echo of the titanic intellectual and moral struggles between realism and liberalism down the centuries – Machiavelli or Hobbes versus Kant, for instance."

[47] Ruggie (1998 p. 3) notes that: "... [T]hey are alike in depicting institutions in strictly instrumental terms, useful (or not) in the pursuit of individual and typically material interests."

[48] See Haas (1990 pp. 7-8)

[49] Ruggie (1998. P. 7)

[50] See Waltz (1979).

[51] Krasner in Smith, Booth and Zalewski (1996 p. 111) suggests that "The exemplary problem for contemporary liberal analysts is market failure; that is, a situation in which a purely individual calculation of interest does not lead to Pareto optimal outcomes."

[52] Ruggie (1998 p. 63) refines 'intersubjectivity' in the following passage: "...[B]y 'intersubjective' we did not mean a state of affairs that exists among analysts, as some of our interlocutors thought; we mean a state of affairs existing among the actors that comprise any given regime. What is *their* understanding of the nature of the regime and of what constitutes unacceptable deviations from it?"

changed and are either expanded, contracted or eliminated, necessitates that the nature of this shared intersubjectivity be problematized and examined.[53] Ruggie judges this something that the positivist epistemology and micro-economic methodologies of the neo-neo synthesis are ill equipped to grasp.

Ruggie's assessment is supported by a number of other international relations scholars who cite significant deficiencies with an approach that is unidimensionally rationalist, structuralist,[54] focused almost exclusively on exogenous determinants of state behaviour and moored to an epistemology that is ill-suited to examining social interactions.

Robert Keohane, who describes the two principal contending impulses in IR theory today as 'rationalist' and 'reflectivist,' presents an important articulation of the divide between the neo-neo project and its critics. Robert Cox,[55] who describes the two competing positions as 'problem-solving' and 'critical' theory,[56] develops a similar representation[57] of the gulf between mainstream IR theory and its challengers.

Forcing unique theoretical voices into one camp or another is an exercise leading invariably to objections by the analysts that are included that distinctions drawn are artificial, and fail to capture faithfully the nuances of each writer's unique efforts.[58] This brings to mind a playful quote by Bob Dylan in DA Pennebaker's film 'Don't Look Back.' In response to a journalist's question about whether he sees himself as a 'folk-rock' singer, Dylan replies: "I've always considered myself a song-and-dance man."

Dylan's view almost assuredly echoes the sentiments of many IR theorists about the artificiality of locating their work in a 'school of thought.' No doubt, many would prefer themselves categorized as song-and-dance men and women rather than rationalist/problem-solvers or reflectivist/critical theorists.

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[53] Ruggie (1998 p. 63)

[54] See Haas (1990 p. 8) for a critique of structuralism. It is important to note that most theorists who fall in the 'critical constructivist' camp accept that structure is important. But they regard structure as socially created rather than simply prescribed by power relationships. See Cox in Rosenau and Cziempel (1992 p. 138).

[55] See Cox (1996: pp. 88-89)

[56] Similar juxtapositions are proposed by Wendt (1992), who contrasts 'power' and 'process' approaches and Radaelli (1995), who contrasts 'power' and 'knowledge' approaches. Others include: Biersteker (1989), Lapid (1989) and Ashley and Walker (1990).

[57] John Hall, in Goldstein and Keohane (1993: pp. 32-33) performs a similar analysis of the literature on sociology in which he compares and contrasts 'materialists' with 'idealists'.

[58] Keohane (1988 pp. 381-382) acknowledges that grouping scholars with distinct perspectives on international relations into one school of thought called 'reflectivist' risks obscuring a number of key differences between them. Wendt (1992 p. 393) also points out this concern, but he too groups together the challengers to 'rationalism' as committed to a more 'sociological' perspective focused on such issues as identity and interest formation.

However valid these protests, it is also true that there is heuristic and pedagogical value to creating 'schools of thought' in theory to allow analysts to compare and contrast similar and divergent impulses and isolate potential areas for improvement. It is with this intent that the following matrix is presented.

Borrowing from the contributions of Keohane and Cox, the matrix divides contemporary IR theory into the two broad categories mentioned above – rationalist/problem solving and critical/reflectivist – contrasting and comparing the positions on a series of critical dimensions.[59] The intention here is to outline crisply key points of contrast and similarity between the two perspectives to determine whether it is possible to isolate opportunities to advance the Statist perspective on Canadian foreign policy by adding where appropriate key insights from reflectivist theory.

Table 1. Comparing Rationalist/Problem-solving theory and Critical/Reflective theory on key dimensions

	Rationalist/Problem-solving	**Critical/Reflective**
General aim	• To explain the world as it is. • In taking this position, rationalist/problem-solving theory: 1. Assumes the functional coherence of existing phenomena[60] 2. Focuses on improving operation of the existing order 3. Has a conservative bias	• Stands apart from the prevailing order and asks how it came to be.[61] • Seeks out sources of contradiction and conflict in existing phenomena and evaluates their potential to change into different patterns.[62] • Emancipatory. As Cox (1996 p. 90) indicates: "Critical theory allows for a normative choice in favour of a social and political order different from the prevailing order, but it limits the range of choice to alternative orders which are feasible transformations of the existing world."

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[59] Similar heuristic efforts are mounted by Wendt (1992), who contrasts 'power' and 'process' approaches and Radaelli (1995), who contrasts 'power' and 'knowledge' approaches. Others include: Biersteker (1989); Lapid (1989) and Ashley and Walker (1990).

[60] Sinclair in Cox with Sinclair (1996 p. 5).

[61] Cox (1996 p. 89).

[62] Sinclair in Cox with Sinclair (1996 p. 6).

Table 1 (con't). Comparing Rationalist/Problem-solving theory and Critical/Reflective theory on key dimensions

	Rationalist/Problem-solving	**Critical/Reflective**
Ontology	• States *qua* states are the primary actors in world politics. • States act as rational, self-utility maximizers. • States operate in a structure given shape by their relative material capabilities.	• At its core are intersubjective understandings and shared meanings that define reality. • There is an international structure. For example, Cox (1996 p. 98) describes a structure composed of three interacting forces – material capabilities, ideas, and institutions. There is no one-way determinism subordinating one to another. How they interact is determined by specific historical conditions.
Epistemology and Methodology	• Positivist. • Focus is on causal explanations where: 1. Independent and dependent variables are conditionally interdependent. 2. The relationship between dependent and independent variables must possess observable implications. 3. A causal explanation must be counterfactually valid. 4. The explanation must apply across cases of the same type.[63]	• Interpretive/hermeneutic • View is that: 1. The assumption of conditional independence and distinction between subject and object is artificial and false. 2. The relationship among social and material phenomenon and their outcomes may not be refuted by observable occurrences. 3. Investigations must remain time-space specific.[64]

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[63] Johnson (2000 p. 9).

[64] Johnson (2000 p. 16).

Table 1 (con't). Comparing Rationalist/Problem-solving theory and Critical/Reflective theory on key dimensions

	Rationalist/Problem-solving	**Critical/Reflective**
History	• Immaterial except as data to be mined for analysis.[65] As Cox (1996 p. 89) notes: "Problem-solving theory is nonhistorical or ahistorical, since it, in effect, posits a continuing present…." • Best suited to analysis in stable historical conditions	• Understanding historical conditions is key to accurate explanation • Best suited to examining periods of historical turbulence and change
Strengths	• Parsimony – fixes limits to a problem area and reduces the statement of a particular problem to a limited number of variables that are amenable to precise examination.[66] • Status as 'normal science'[67] in international relations with a widely accepted 'research program.' • Generally accepted by students and practitioners as having broad policy applicability	• Brings people and ideas into the picture. • Focuses on origins of actions and is thus designed to engage the explanation of change in world politics • Introduces historical conditions as a key variable.

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[65] As Sinclair, quoting Cox, notes in Cox with Sinclair (1996 p.7) in positivist method: "History becomes but a mine of data illustrating the permutations and combinations that are possible within an essentially unchanging human story."

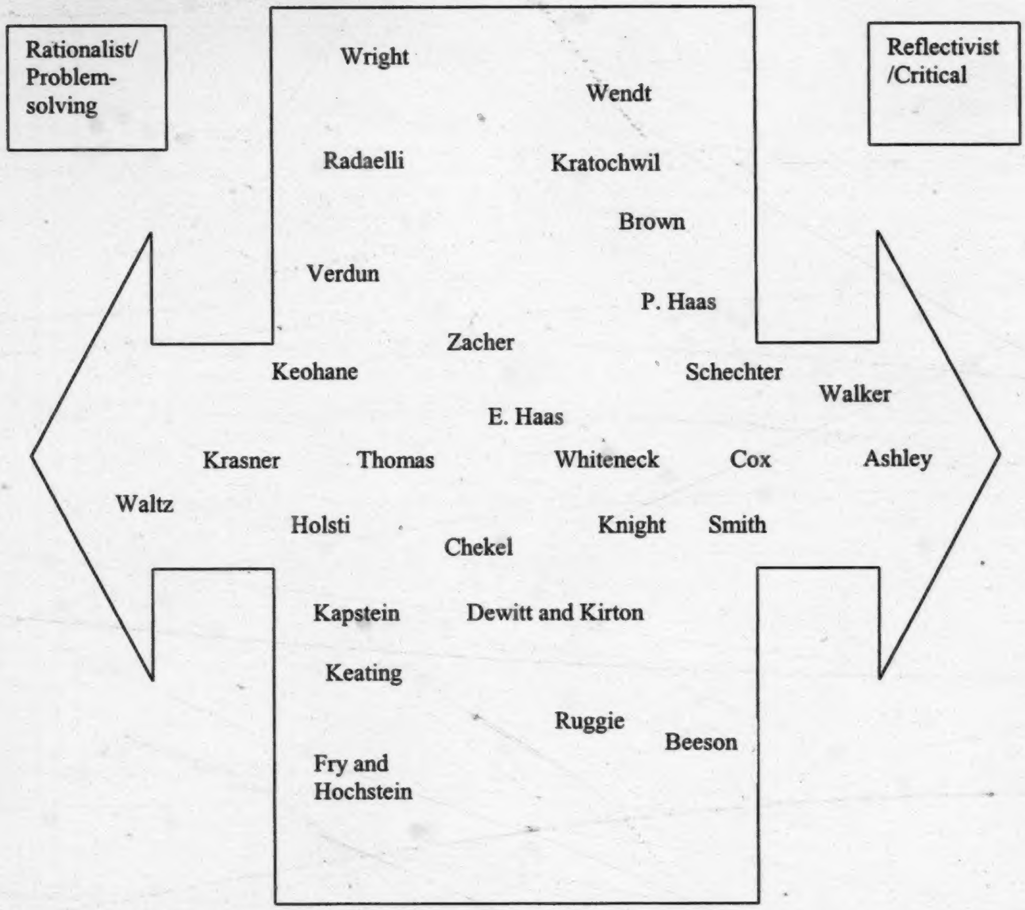
[66] Cox (1996 p. 88)

[67] Sinclair engages the notion of 'normal science' in international relations in the following passage from Cox with Sinclair (1996 p. 13): "A generation of international relations scholars has been trained in the United States in terms of a prevailing ethos of what Kuhn would call normal science, in which many of the analytical tools that have come to dominate public policy studies and the field of American politics more generally have been applied to 'issue areas' within inter-state affairs, much as these were applied to relations between the US states."

Clearly, there are a number of critical distinctions between the two perspectives – and the matrix speaks for itself on these. However, beyond simply depicting similarities and differences, the matrix assists in isolating areas where the strengths of one approach can be employed to improve the weaknesses of the other. The thought that there may be an opportunity to evolve theory by doing precisely this has occurred to a number of IR theorists. The model below illustrates this.

The "IR Theory Continuum" positions a selection of theorists cited in the Bibliography of this dissertation on a single axis, with the Reflectivist/Critical approach at one pole and the Rationalist/Problem-solving perspective at the other. The closer to a pole an analyst is plotted, the more closely she can be identified as operating within the theoretical tradition the pole represents.

Figure 1. IR Theory Continuum


Rationalist/ Problem-solving
Reflectivist /Critical
Wright
Wendt
Radaelli
Kratochwil
Brown
Verdun
P. Haas
Zacher
Keohane
Schechter
Walker
E. Haas
Krasner
Thomas
Whiteneck
Cox
Ashley
Waltz
Holsti
Chekel
Knight
Smith
Kapstein
Dewitt and Kirton
Keating
Ruggie
Beeson
Fry and Hochstein

There are a number of insights that can be drawn from this simplified analysis. For example, there is some evidence of possible convergence between the two approaches. This is demonstrated by the cluster of analysts coalescing in the middle of the continuum rather than at either of the two poles.

Two factors contribute to this result. First, rationalist/problem-solving and reflectivist/critical theories are not completely separate and distinct. As Cox notes, sophisticated versions of both rationalist/problem solving theory and reflectivist/critical theory contain elements of both perspectives, though one is generally favoured over the other.[68]

Second, analysts from both traditions are labouring to enhance the explanatory validity of their specific approaches. As suggested above, this can mean that theorists look to the contending perspective to identify strengths that may be incorporated into a favoured approach to address an apparent weakness. Keohane has also observed this trend. He suggests that the potential outcome of this activity may be a synthesis of the rationalist/problem-solving and reflectivist/critical perspectives.[69]

While this result takes convergence further than, particularly critical theorists, may be willing to go – principally because critical theorists seek to stand apart from the *status quo* and ask how it came to be rather than taking it for granted and hoping to make it operate more efficiently[70] – there is clearly energy in IR theory being dedicated to peeking over the wall that separates the two schools of thought.

However, a cautionary note is necessary to consider the continuum plotting outcomes properly. They are distorted somewhat given that the scholars chosen were selected because they are consciously theoretical and the exercise itself was focused on isolating potential opportunities for advancing theory.

If a more representative cross-section of IR writers were to be taken it would show a large majority clustering at the rationalist/problem-solving end of the continuum. This is a consequence of the dominant position that rationalist/problem-solving theory retains in the field of IR theory.

Keohane judges that the dominance of the rationalist/problem-solving approach continues[71] primarily due to the strength of its research program.[72] With its ability to examine issues in a 'value-neutral' and 'scientific' way – which, as noted in the matrix presented above, is a point that is hotly disputed by critical/reflectivist scholars who regard the rationalist/problem-solving approach as having both a conservative bias and a lamentable record on 'scientific prediction'[73]– its contribution to the literature on international relations is undeniable. As Keohane suggests:

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[68] Cox in Cox with Sinclair (1996 p. 91) notes that: "Problem solving and critical theory are not necessarily mutually exclusive. They may be understood to address different levels or concerns within one overall story."

[69] Keohane (1988 p. 393).

[70] Cox in Cox with Sinclair (1996 pp. 88-89) describes the purpose of critical theory in the following passage: "It is critical in the sense that it stands apart from the prevailing order of the world and asks how that order came about. Critical theory, unlike problem-solving theory, does not take institutions and social power relations for granted but calls them into question by concerning itself with their origins and how and whether they might be in the process of changing. It is directed toward an appraisal of the very framework for action, or problematic, which problem-solving theory accepts as its parameters."

[71] Keohane (1988 p. 392) comments that: "…[T]he critics have by no means demolished the rationalistic research program …."

> A research program with such a record of accomplishment, and a considerable number of interesting but still untested hypotheses about reasons for persistence, change, and compliance, cannot be readily dismissed.[74]

While it remains to be seen whether the reflectivist/critical approach will displace the rationalist/problem-solving view as the dominant perspective in IR theory over the long term, its emergence alone has had an immediate impact on at least the more theoretically conscious analysts of international relations. As a corollary, some of the key assumptions of the rationalist/problem-solving position have been challenged. Consequently, a series of potentially interesting opportunities to enhance the explanatory accuracy of 'normal science' in IR theory have been revealed.

Borrowing from Cox's reference to Braudel's 'ship' metaphor on theory, the reflectivist/critical challenge has pressed some international relations scholars to "... find out in which set of circumstances the ship ...[of mainstream theory] ... [will] ... sail well. You do not scuttle a ship because it will not sail in every circumstance. You can take care to not use it where it will not work, but you do use it where it will."[75]

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[72] Keohane (1988 p. 392) states that: "Limiting the number of variables that a theory considers can increase both its explanatory content and its capacity to concentrate the scholarly mind. Indeed, the rationalistic program is heuristically so powerful because it does not easily accept accounts based on *post hoc* observation or values or ideology: regarding states as rational actors with specified utility functions forces the analyst to look below the surface for interests that provide incentives to behave in apparently anomalous ways." Critical/reflective thinkers would suggest that this passage depicts clearly a key deficiency in the rationalist/problem-solving approach. It is that despite rationalist/problem-solving theory's invocation of value-neutral science, it is every bit as ideological and biased as it claims its potential challengers to be in that it cleaves to a conservative understanding of international relations. Moreover, as noted by Cox and others, limiting the number of variables that a theory considers may in fact deliver less explanatory content than a more eclectic approach could yield.

[73] Sinclair in Cox with Sinclair (1996 p. 5) observes the following about the predictive capabilities of rationalist/problem-solving theory: "Mainstream approaches to international politics have not lived up to their scientific aspirations and have failed to predict ... [important historical] developments. The change in the form of the Cold war came as more or less of a complete shock to the policy intellectuals informed by neo-realist or related frameworks."

[74] Keohane (1988 p. 392).

[75] Cox (in Cox with Sinclair 1996 p. 177).

To extend the metaphor, it is also possible to modify a ship to render it seaworthy under more conditions than it was originally intended to sail. Hence, a retrofit of the rationalist/problem-solving approach can be contemplated to respond to at least some of the challenges of reflectivist/critical theory. This can be accomplished in part by, first, specifying the historical conditions in which a particular event under examination occurred;[76] and second, by introducing the concepts of shared intersubjectivities and ideas to analysis. The work of Robert Cox offers some interesting insights on both.

As already mentioned, ontology must be the point of entry for any fundamental theoretical enquiry. It is impossible to think of a theory of international relations without first specifying the actors involved and the ways they interact. In addition, any adumbration of participants and their relations ought to be rooted in an historical structure since, as Cox notes, "The ontologies that people work with derive from their historical experience and in turn become embedded in the world they construct."[77] Historical conditions matter[78] - and they have a key determinative impact on the kind of world that people create and how they choose to interact within it.

Cox's challenge to the ahistorical rationalist/problem-solving view of international relations is fundamental – though he does not suggest wholesale abandonment of mainstream theory as a preferred alternative. He advises instead that both rationalistic/problem-solving theory and reflective/critical theory are useful, and that the former is in fact well-suited to explicating events where there is "relative stability in the fundamental structures and relationships that constitute international relations."[79] So, rationalist/problem-solving theory can be functional – but, it must be located within "…defined historical limits,"[80] which he describes as 'synchronic' moments in time.[81]

Cox's view on 'synchronic' moments and how to study them is described in the following passage:

> 'Persistent patterns' amongst the selected intersubjectively linked constituted entities can be identified by stopping the movement of history, and 'conceptually fixing a particular social practice.' In simple terms, this means that the analyst must specify

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[76] The need for theory to be 'historically contextualized' is also noted by Keohane (1988 p. 393).

[77] See Cox in (Cox with Sinclair 1996 p. 144).

[78] In writing about Muslim scholar Ibn Khaldun, Cox (in Cox with Sinclair 1996 p. 165) observes that: "Ibn Khaldun's reflections on world history contemplated the 'world' that would have been intelligible to him, just as ours contemplates the 'world' intelligible to us. Any such reflections are historically conditioned. A first requirement, accordingly, is to become conscious of that conditioning."

[79] Sinclair in (Cox with Sinclair 1996 p. 6).

[80] Sinclair in (Cox with Sinclair 1996 p. 7).

[81] Sinclair in (Cox with Sinclair 1996 p. 10).

> the core relationships and the parameters of the object in question in a systematic way before other considerations take place. The ideal type can now be compared and contrasted with other social practices to assess its significance.[82]

Cox judges that Rationalist/Problem-solving theory is suited to engaging these kinds of 'synchronic' issues.

It is important to point out that in his own work, Cox moves on from examination of synchronic moments to articulate a different kind of analysis than that contemplated by mainstream IR theory. He takes his discussion of world politics significantly beyond mainstream theory by focusing on change in fundamental historical structures with the intention of positing alternative world orders.[83]

However, even in doing so, he does not abandon synchronic analysis. Analysis of synchronic moments is instead embedded within a concern for understanding larger 'diachronic' developments – that is, "… the tendencies to social transformation arising from the contradiction between ascendant and descendant social forces."[84] Cox is interested not only in what the world is – he is also concerned with what it can and should be.

Mainstream IR theory generally does not take up questions as theoretically complex as those examined by Cox. If theory is engaged at all in the normal science of IR, it is more likely in the sense of the 'synchronic moments' that Cox describes. As noted, Cox sees no difficulty in this – as long as historical conditions are specified. This point will be examined in detail in Chapter 3 of this dissertation when methodology is discussed.

Cox also offers a compelling perspective on the importance of creating a place for 'intersubjective' understandings and ideas in world politics. In this he is joined by 'constructivists,' [85] currently the largest group of scholars in the reflectivist/critical school. Most of the analysts clustering toward the centre of the IR theory continuum heuristic featured above favour a position on theory that can be characterized as, at least loosely, constructivist in orientation.[86]

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[82] Sinclair (in Cox with Sinclair 1996 p. 10).

[83] As Sinclair (in Cox with Sinclair 1996 p. 14) observes: "Robert W. Cox's work is motivated by fundamentally different purposes from that of mainstream neorealist international relations scholarship. He seeks to understand transformation of historical structures in order to influence change along the lines of what Gill has called the 'self defence of society.' To this critical purpose he marries an historicist epistemology, allocating positivism to the questions of detail and synchronic modeling."

[84] Sinclair (in Cox with Sinclair 1996 p. 14).

[85] To trace the origins of social constructivism see: Ruggie (1998 p. 11); Katzenstein (1996) and Lapid and Kratochwil (1996).

[86] Overviews of the constructivist approach are presented in Wendt (1994) and Chekel (1998).

While they share a broad commitment to the importance of introducing concepts like ideas and shared intersubjectivities to IR theory, there are also a number of important differences between analysts within the 'constructivist' perspective. Interestingly, the divide is very similar to the one between rationalist/problem-solving theory and reflective/critical theory.

The more 'conventional' group of constructivists regards its project as one of filling a critical gap in the ontological orientation of rationalist/problem-solving theory by adding, *inter alia*, ideas, shared intersubjectivities, gender, ethnicity and class to analysis. The epistemological orientation of this group remains broadly positivist. [87] Though they may bridle at being selected as an example, and they certainly do not identify themselves as being within the constructivist tradition, the work of Keohane and Goldstein on ideas in foreign policy – which is discussed in the next chapter – can be considered to fit within this category.[88]

The other camp of constructivists is more critical in orientation. As with Cox, its challenge to the ontology of rationalist/problem-solving theory is fundamental. Ideas and shared intersubjectivities are not additional hues to be added to complete a rationalist/problem-solving ontology. Again, as outlined by Cox - they are an essential constitutive element of an alternative ontology. In addition, many of these constructivists reject the rationalist/problem-solving commitment to positivism. They employ instead an epistemology more in common with the historicist methods of critical theory. [89] The social constructivist work of John Ruggie is an example of this orientation.[90]

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[87] As Laffey and Weldes (1997 p. 196) note, more conventional constructivism "… begins with the same model of rationality [as rationalists] and introduces additional variables in order to account for deviations from expected outcomes, specifically by identifying ideas on the basis of which the actors engage in substantively rational action. This has prompted some critics to describe the ideas literature not as a challenge to the rationalist approach but rather as its completion." Chekel (1998 p. 327) expands on the point by observing that: "It is important to note that constructivists do not reject science or causal explanation; their quarrel with mainstream theories is ontological, not epistemological."

[88] Goldstein and Keohane (1993: p. 6) develop their position on the importance of ideas – and also their challenge to both the rationalist and reflectivist viewpoints on ideas – in the following passage: "This volume was written as a challenge to both rationalist and reflectivist approaches. Although we concede that the rationalist approach is often a valuable starting point for analysis, we challenge its explanatory power by suggesting the existence of empirical anomalies that can be resolved only when ideas are taken into account. We demonstrate this need to go beyond pure rationalist analysis by using its own promise to generate our null hypothesis: that variation in policy across countries, or over time, is entirely accounted for by changes in factors *other than* ideas. Like reflectivists, we explore the impact of ideas, or beliefs, on policy. But this volume also poses an explicit challenge to the antiempiricist bias of much work in the reflectivist tradition, for we believe that the role played by ideas can and should be examined empirically with the tools of social science."

[89] This view is shared by Ruggie (1998 p. 38) – who considers himself a social constructivist. He points out that it is not just the ontological components of mainstream IR theory that needs to be challenged – it is the epistemology as well: "Everything hinges, of course, on what is meant by 'normal science.' On my reading, 'normal science' in international relations has a hard time grasping truly intersubjective meanings at the international level, as opposed to aggregations of meaning held by individual units: it lacks the possibility that ideational factors relate to social action in the form of constitutive rules; it is exceedingly uncomfortable with the notion of noncausal explanation, which

Despite these differences, constructivists share a concern that the rationalist/problem-solving perspective paints an uni-dimensional caricature of international relations. Instead of a system swirling with the passions, beliefs, thoughts, interactions and dreams of real people embedded in a specific historical context, rationalist/problem-solving theory posits a world where the die is cast for actors by utility calculations related almost exclusively to maximizing material interests within a system structured by the relative power capabilities of states. While that view may be a parsimonious fiction convenient for modeling events in the world of policy analysis, constructivists contend that it is a fiction nonetheless.

From the constructivist viewpoint, people and their ideas,[91] beliefs and cultures[92] must be incorporated as important drivers of the state policy-making process.[93] As Ruggie argues: "At bottom, social constructivism seeks to account for what neo-utilitarianism assumes: the identity and/or interests of actors."[94] By granting phenomena like 'ideas'[95] prominence of place, constructivists acknowledge that agency matters. Actors do not follow pre-ordained scripts. They are able, within

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constitutive rules entail; and even though it is almost never achieved in practice – and in most instances cannot be achieved – the 'normal science' of international relations nevertheless aspires to the deductive-nomological model of causal explanation, while dismissing even rigorous forms of the narrative mode as mere story-telling."

[90] See Ruggie (1988).

[91] It is important to note that the role of 'people' and 'ideas' in formulating and executing foreign policy has been tackled previously in the literature on international relations. For example, the literature on decision-making – drawn largely from the tradition of psychology, see Jervis (1976) and Holsti (1979) – and the bureaucratic politics perspective - see Allison (1971) - have provided useful insights into decision-making within the state. But, these approaches have had limited impact on the central debates in international relations "theory" – that is, the role of the system, relationships between state and society, and so on. Moreover, the bureaucratic politics perspective suffers from the same kinds of deficiencies pointed up by constructivists in their critique of 'neo-neo' synthesis literature. This is because, in many ways, it structures the world of government within a state in the same fashion as the 'neo-neo' synthesis organizes international relations. In the bureaucratic politics perspective, the analogs for states are the agencies within government, which react to the power relationships that exist in the system – in this instance, government – which they operate within. Individual participants who make up these agencies remain unexamined to any significant degree, as they are viewed simply as deducing their courses of action through rational calculations focused on utility maximization for their agency. As a consequence, the role of individuals and their beliefs and ideas remains – as with the 'neo-neo' project – largely unconsidered.

[92] On culture, see Ruggie (1998 p. 15).

[93] As Shaw notes in Stiles (2000 p. 2): "Comparative and international, local and global studies in the social sciences can no longer, if they ever did, treat only one level of analysis or one type of actor. Instead, we have to go beyond Susan Strange's insistence that we bring in not only states but also firms to the incorporation of a trio of actor types at all levels: in other words, civil societies as well as governments and corporations."

[94] Ruggie (1998 p. 4).

[95] Biersteker in Rosenau and Cziempel (1992 p. 120) seeks to address how it is that ideas come to influence actual policy-making activity.

the structure and conditions that they find, and create,[96] for themselves,[97] to plot and fulfill their own destinies.[98]

In making this point, constructivists do not reject structure, power, material capabilities and the like as important independent variables in world politics.[99] Instead, they disavow "… the pretense or presumption that the study of such phenomenon constitutes the totality of the social scientific enterprise."[100]

By considering both exogenous and endogenous influences, constructivist's contend that a more complete depiction of international relations is possible. The opportunity exists to pierce the billiard ball of the state as characterized by the rationalist/problem-solving approach, and consider shared and competing thought processes of individuals as essential determinants of policy outcomes.[101]

As with Cox, constructivists draw on literature from outside mainstream international relations analysis – for example, linguistics, anthropology and sociology[102] - to introduce concepts like 'shared intersubjectivities'[103] – or, as

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[96] Chekel (1998: p. 326) points out that: "Constructivists emphasize a process of interaction between agents and structures; the ontology is one of mutual constitution, where neither unit of analysis – agents or structures – is reduced to the other and made 'ontologically primitive.'"

[97] For example, as Cox notes in Rosenau and Cziempel (1992 pp. 138-139), historical change just does not 'happen' – it is made to happen through changes in intersubjectivity.

[98] See Chekel (1998 p. 327) for a fuller articulation of this point.

[99] Cox (in Cox with Sinclair 1996: p. 149) sees structure as a key component of world politics. However, unlike rationalist/problem-solving theorists who regard structure as comprised of the comparative material capabilities of states alone; Cox proposes a structure that is created by the interaction of material capabilities, ideas and institutions.

[100] Ruggie (1998 p. xi).

[101] Knight in Stiles (2000 p. 42) suggests that "… [T]o properly understand a state's international behaviour, including the self-image it projects abroad, one must begin by penetrating within the billiard ball model of interstate relations as a means of exposing the 'form' and nature of the state-society model as a whole." For further critiques of the state as 'billiard ball' metaphor see: Ashley in Smith, Booth and Zalewski (1996: p. 241); Mann in Smith, Booth and Zalewski (1996: p. 224); Linklater in Smith, Booth and Zalewski (1996: p. 294); Cziempel in Rosenau and Cziempel (1992: p. 282); Cox in Rosenau and Cziempel (1992: p. 142) and Cornett and Caparosa in Rosenau and Cziempel (1992: p. 236).

[102] Ruggie (1998 p. 12) identifies the origins of the 'social fact' concept – which is also described by the term 'shared intersubjectivities' in the international relations literature – in the following passage: "Following Durkheim (1938), I termed these [shared intersubjectivities] 'social facts' – which John Searle has recently (1995) defined simply as those facts that are produced by virtue of all the relevant actors agreeing that they exist."

[103] Cox (in Cox with Sinclair 1996: p. 145) describes the importance of shared intersubjectivities in the following passage: "The ontologies that people work with derive from their historical experience and in turn become embedded in the world they construct. What is subjective in understanding becomes objective through action. That is the only way, for instance, in which we can understand the state as an objective reality. The state has no physical existence, like a building or a lamppost; but it is nevertheless a real entity. It is a real entity because everyone acts as though it were; because we know that real people with guns and batons will enforce decisions attributed to this nonphysical entity."

Ruggie describes them, 'social facts'[104] – to the analysis of world politics. Social facts operate to specify for decision-makers, *inter alia*, a common language about issues as well as potential terrain for coordinated activity.

Ruggie develops the pertinence of social facts to the real world of international relations by suggesting that institutions like Bretton Woods encompassed much more than a series of formal agreements created by actors to manage the post-war international economy. Bretton Woods also produced – and was produced by[105] - salient intersubjective frameworks of meaning which enabled decision-makers to examine future issues in a similar fashion and manage them cooperatively.[106]

Therefore, in this view, it is not an international system structured by power calculations of rational states that drives world politics alone. Instead, shared understandings amongst real people – mediated, of course, by systemic realities like military and economic capabilities - also have a determinative impact on events in the international system.[107]

While there is broad agreement amongst constructivists that shared intersubjectivities and ideas should be brought in to present a more complete view of international relations, it is also the case – as indicated above – that there is a wide gap between analysts on how this should be accomplished. It is in this area that both reflectivist/critical constructivists – and reflectivist/critical theory generally - have been less successful.

While the shortcomings of positivist epistemology have been well articulated by theorists in the reflective/critical vein, these scholars have been challenged to present an alternative that will attract widespread support[108] and that will provide better explanations of real international events than rationalist/problem-solving theory.[109]

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[104] Ruggie (1998 p. 13) notes that: "The distinguishing feature of social constructivism is that it concerns itself with the nature, origins, and functioning of social facts, and what if any specific methodological requirements their study may entail." Ruggie (1998 p. 12) provides the following as examples of social facts: "Social facts … include states and their collective institutional practices … and the likes of marriage, money, football, property and Valentine's Day."

[105] This notion of 'production' is a key insight of Cox's analysis. To Cox, as Sinclair notes in Cox with Sinclair (1996: p. 9): "Production … includes the production of ideas, of intersubjective meanings, of norms, of institutions and social practices, i.e. of the whole of the context of ideas and institutions within which the production of material goods takes place. Looking at production is simply a way of thinking about collective life, not a reference to the 'economic' sectors of human activity (such as agriculture, commerce, industry, and so forth)."

[106] Ruggie (1998 p. 21).

[107] Wendt (1992 p. 407) notes that: "If states find themselves in a self-help system, this is because their practices made it that way. Changing the practices will change the intersubjective knowledge that constitutes the system."

[108] Goldstein and Keohane (1993 p. 6) note that: "Unfortunately, reflectivist scholars have been slow to articulate or test hypotheses. Without either a well-defined set of propositions about behaviour or a rich empirical analysis, the reflectivist critique remains more an expression of understandable frustration than a working research program."

Some reflective/critical theorists respond to this judgment suggesting that this is not the point of their analysis - though others have acknowledged the issue.[110] In Keohane's view, it is this lack of a compelling 'research program' that has held the reflectivist/critical position back from advancing as a serious contender to 'normal science' in international relations.[111]

Keohane's provocation about the lack of a rigorous research program for reflectivist/critical theory has been responded to by a number of analysts. Ruggie cites the following examples:

> Ernst Haas has been moving toward his own brand of an 'evolutionary epistemology,' wherein consensual knowledge about various aspects of the human condition becomes one of the forces behind the rise and decline of international regimes. Robert Cox has developed an unconventional historical materialist epistemology, which gives pride of place to shifting intersubjective frameworks of human discourse and practice. An epistemological position derived from the 'universal pragmatics' of Juergen Habermas has

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[109] Krasner in Smith, Booth and Zalewski (1996 p. 125) and Ruggie (1998 p. 194) has developed compelling statements of this issue. Nicholson (in Smith, Booth and Zalewski 1996 p. 132) argues in his examination of famines that at its worst, reflectivist/critical theory borders on 'eccentricity': "I find no difficulty of thinking of these 'facts' about famine which it would be eccentric to deny, established by methods which it would be eccentric to deny. The analysis of famines is not done as an intellectual exercise but for its possible, indeed probable use in preventing or at least alleviating future famines. Such alleviating means intervening in a process which has been understood (positivistically) where we have some strong reasons for assuming what the consequences of the intervention will be."

[110] This is an issue that is a point of debate amongst critical theorists. Jackson in Smith, Booth and Zalewski (1996 p. 208) suggests that Weber's '*verstehen*' – or 'interpretive' approach is as precise as positivism. In contrast Cox, (in Cox with Sinclair 1996: p. 89) acknowledges the issue in the following passage: "Because it deals with a changing reality, critical theory must continually adjust its concepts to the changing object it seeks to understand and explain. These concepts and the accompanying methods of enquiry seem to lack the precision that can be achieved by problem-solving theory, which posits a fixed order as its point of reference."

[111] Keohane (1988 p. 392) develops this point in the following passage: "Indeed, the greatest weakness of the reflective school lies not in deficiencies in their critical arguments but in the lack of a clear reflective research program that could be employed by students of world politics. Waltzian neorealism has such a research program; so does neoliberal institutionalism, which has focused on the evolution and impact of international regimes. Until the reflective scholars or others sympathetic to their arguments have delineated such a research program and shown in particular studies that it can illuminate important issues in world politics, they will remain on the margins of the field, largely invisible to the preponderance of empirical researchers, most of whom explicitly or implicitly accept one or another version of rationalistic premises."

> been found fruitful and other possibilities have been probed as well.[112]

A number of other approaches have been developed which also seek to capture the strengths of both the rationalist/problem-solving and the reflectivist/critical positions – and embed them within workable research programs. Analysts have employed concepts such as 'issue networks,'[113] 'advocacy coalitions,'[114] 'policy networks,'[115] 'interpretive communities,'[116] 'policy communities'[117] and 'bounded communities'[118] to explore the impact of common concerns like shared intersubjectivities, ideas, the role of experts on policy-making and transmission of ideas in international relations. A further initiative in this vein[119] that has produced a following in the literature on international relations is the 'epistemic community' approach.'[120] It is toward an examination of epistemic community[121] that analysis turns in Chapter 2.

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[112] Ruggie (1998 pp. 96-97). Johnson (1990) notes a number of other examples, including Alexander Wendt and Friedrich Kratochwil and David Little. She also offers her own view on a potential way forward.

[113] See: Thomas (1997: pp. 2-3)

[114] See: Sabatier and Pelkey (1987); Sabatier (1998); Sabatier and Jenkins-Smith (1993).

[115] See: Verdun (1998: p. 6)

[116] See: Makinda (2001: p. 13)

[117] See: Wright (1998: pp. 51-55) for a discussion of what he describes as the 'policy communities' literature.

[118] See: Linklater in Smith, Booth and Zalewski (1996).

[119] It is important to note that many of these perspectives are in fact difficult to distinguish from the epistemic community concept.

[120] As Ruggie (1998 p. 19) notes: "The major venue for constructivist explorations of the impact of causal beliefs have been via 'epistemic communities,' or transnational knowledge-based experts." A similar point is made by Chekel (1998 p. 328)

[121] For example Ernst Haas, (1990 p. 352) in a book that preceded Peter Haas' published work on epistemic communities, also employed the notion of 'epistemic community.' He pressed the concept up against specific potential areas of enquiry in an effort to scope a broad 'research program' for scholars to employ – not dissimilar to what Keohane called for in his article on reflectivism and rationalism. Ernst Haas developed 'ten propositions' for research that many analysts who followed clearly used to inform their analyses.

Chapter Two

Epistemic Communities

Ideas in Foreign Policy

As noted in Chapter 1, the impact of 'ideas' is a subject engaged with greater frequency and rigour recently in the theoretical literature on international relations. Biersteker suggests that ideas are used in IR analysis to explain issues like 'policy emulation' – for example, when Newly Industrialized Countries (NICs) adopt policy approaches employed by industrialized countries – the role and influence of experts on policy outcomes and the impact of interest groups and other cadres of civil society on the foreign policy development process.[122]

IR analysts employing ideas in their investigations reach back principally to Max Weber[123] and Emile Durkheim[124] for inspiration. Weber's contribution to the field of sociology on the subject of ideas and their effect on social relations has had an enduring impact within the social sciences. The extrapolation of his insights to international relations has created some exciting possibilities for analysis. Particularly intriguing to students of IR is his famous conceptualization of ideas operating in social relations as 'railway switchmen.'[125]

The importance of the 'ideas as railway switchmen' simile is acknowledged by Goldstein and Keohane in their book *Ideas and Foreign Policy:*

> In general, we see ideas in politics playing a role akin to that enunciated by Max Weber early in this century: 'Not ideas, but material and ideal interests, directly govern man's conduct. Yet, very frequently the 'world images' that have been created by ideas have, like switchmen, determined the tracks along which action has been pushed by the dynamic of interest.' Ideas help to order the world. By ordering the world, ideas may shape agendas, which can profoundly shape

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[122] Biersteker in Rosenau and Cziempel (1992 p. 120)

[123] On the influence of Weber, see the contributions of Jackson, Hall and Ikenberry in Goldstein and Keohane (1993).

[124] See Ruggie (1998 p. 28).

[125] Hall in Goldstein and Keohane (1993 p. 48). Some reflectivist/critical analysts reject the ideas as 'switchmen' simile as it presumes that tracks are already laid for actors to direct debate along. As Hall in Goldstein and Keohane (1993 p. 48) notes: "Any complete and uncritical acceptance of this metaphor is likely to restrict vision, making it difficult to recognize the most fundamental ways in which ideas affect the historical record. The essential problem is that the metaphor takes for granted that the railway lines or tracks have already been laid; that is, that a social order is already in place. But, the moments of most autonomous ideological power have been those in which intellectuals have served – to make use of Michael Mann's fundamental amendment of Weber – as 'tracklayers', that is, as the creators of society."

> outcomes. Insofar as ideas put blinders on people reducing the number of conceivable alternatives, they serve as invisible switchmen, not only by turning action onto certain tracks rather than others, as in Weber's metaphor, but also by obscuring the other tracks from the agent's view.[126]

Goldstein and Keohane's book – which is presented as a challenge to both the rationalist/problem-solving and reflectivist/critical positions on ideas[127] - seeks to haul ideas into the 'normal science' of IR literature.[128] They view ideas as, *inter alia*,[129] roadmaps or 'frames'[130] that, particularly under conditions of uncertainty,[131] provide a key supplement to the state policy-making process.

Goldstein and Keohane argue that ideas guide the actions of decision-makers by establishing terms of reference within which policy debates develop and then decisions are taken. Decision-makers can lean on agreed upon historical examples, ideology, morality, and any number of other 'shared intersubjectivities,' to winnow down preferred courses of action. Moreover, if a new idea emerges and finds favour with a critical mass of key stakeholders, it can operate as an engine to drive change in the system.[132]

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[126] Goldstein and Keohane (1993 pp. 11-12). They draw this Weber quote from his essay: "Social Psychology of the World Religions." In H.H. Gerth and C. Wright Mills (eds.) *Max Weber: Essays in Sociology*. New York: Oxford University Press, 1958. (p. 280).

[127] Goldstein and Keohane (1993: p. 6) develop their challenge in the following passage: "This volume was written as a challenge to both rationalist and reflectivist approaches. Although we concede that the rationalist approach is often a valuable starting point for analysis, we challenge its explanatory power by suggesting the existence of empirical anomalies that can be resolved only when ideas are taken into account. We demonstrate this need to go beyond pure rationalist analysis by using its own premise to generate our null hypothesis: that variation in policy across countries, or over time, is entirely accounted for by changes in factors *other than* ideas. Like reflectivists, we explore the impact of ideas, or beliefs on policy. But this volume also poses an explicit challenge to the antiempiricist bias of much work in the reflectivist tradition, for we believe that the role played by ideas can and should be examined empirically with the tools of social science."

[128] Goldstein and Keohane (1993: p. 4) observe that in the 'normal science' of IR literature: "…ideas are unimportant or epiphenomenal either because agents correctly anticipate the results of their actions or because some selective process ensures that only agents who behave as if they were rational succeed."

[129] Goldstein and Keohane (1993: pp. 12-13) suggest that ideas also contribute to specific policy outcomes in the absence of 'unique equilibrium' and further that ideas embedded in institutions specify policy in the absence of innovation.

[130] See Raedelli (1996) for use of the 'policy frame' in analysis.

[131] Goldstein and Keohane (1993: pp. 13-14).

[132] Goldstein and Keohane (1993 p. 16) note that "… [F]or us, the important question is the extent to which *variation* in beliefs, or the manner in which ideas are institutionalized in societies, affect political action under circumstances that are otherwise similar. Does it matter that policy makers in China believed in Stalinist political economy, or that elites after World War II were deeply imbued with conceptions of human rights? That is, do people behave differently than they would if they were just pursuing individual self-interest in a narrowly utilitarian sense?"

In this fashion, ideas can be powerful forces for shaping history.[133] For example, a number of the case studies in Goldstein and Keohane's book demonstrate the centrality of ideas to such significant historical milestones as Bretton Woods, decolonialism,[134] the growth of an international human rights agenda in the post-war system and the impact of Stalin's economic policies on China. They judge it unlikely that these outcomes could have been contemplated by an analysis that sought only to weigh the relative material interests and capabilities of the various states involved.[135]

Keohane's book with Goldstein represents, in part, his own response to the provocation he voiced in his 1988 Presidential Address to the International Studies Association (ISA). By incorporating ideas into analysis, Goldstein and Keohane seek to fill a significant ontological gap in rationalist/problem-solving theory while at the same time retaining what they believe to be one of its most important dimensions – a commitment to a rigorous research program focused on illuminating policy issues in world politics.[136]

Importantly, reflectivist/critical scholars also agree that theory should not be an arid, intellectual exercise divorced from real world events. As Cox notes:

> How does a new field of academic enquiry come into existence? Not surely through some form of intellectual parthenogenesis whereby existing realms of academic enquiry subdivide and multiply on their own. The new field is born from the fertilization of experienced enquiry. Something important is going on that the academy cannot explain to our satisfaction. Sensitivity to the real world is the primary ingredient, a sensitivity that is the salient qualification of the good journalist.[137]

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[133] See Ikenberry in Goldstein and Keohane (1993 p. 84).

[134] The point is emphasized by Jackson in Goldstein and Keohane (1993 p. 132) who judges that "… decolonization was fundamentally a revolution not of power but of ideas about what is legitimate and illegitimate in international politics."

[135] As Ikenberry explains in Goldstein and Keohane (1993 p. 61), in his account of the creation of the post-war Bretton Woods agenda, "… the substantive content of the system was shaped by Great Britain as well as by the United States and in ways that would be unanticipated by simple considerations of power."

[136] By doing so, Goldstein and Keohane confront head-on Ruggie's remonstration against approaches that combine a positivist epistemological position with an ontology that incorporates intersubjectivity (see Ruggie: 1998: p. 86). Before engaging Goldstein and Keohane's point, it is important to note that Ruggie's argument was focused specifically at neorealism and its attempt to address norms and principles via positivist means. Nevertheless, his critique obtains for rationalist/problem-solving approaches generally when they seek to incorporate concepts like ideas into analysis. Keohane and Goldstein buttress their position by noting that while analysts should be aware of the need to mesh ontology and epistemology, this should not prevent ideas being addressed by positivist means. To block that path, they warn, would serve only to consign a potentially fruitful discussion "… to the purgatory of incompatible epistemologies." (See Goldstein and Keohane. 1993: p. 26).

[137] Cox (in Cox with Sinclair 1996: p. 176).

Cox's last sentence in the passage above provides a key insight into how many reflectivist/critical scholars have taken up the task of engaging real world events. Instead of employing the deductive-nomological approach relied on by rationalist/problem-solving analysts, they utilize, as noted in Chapter 1 of this dissertation, interpretive methods which cast historical events as the central component of analysis. However, clearly mindful of criticisms leveled by rationalist/problem solving analysts that the results of historical analysis can occasionally amount to 'mere storytelling,' other reflective/critical analysts have turned to the rationalist/problem-solving approach to assist in constructing an alternative research program. An important example is the literature on epistemic community.

The Origins of the Epistemic Communities Approach

Brought into discussions on IR theory in the late 1980's and early 1990's by such analysts as Ruggie, Adler and Haas, the epistemic community approach seeks to position phenomenon like 'ideas', 'learning' and 'knowledge' as central determinants of world politics. Moreover, in response to critics like Keohane in his address to the ISA,[138] many proponents of the epistemic community perspective have sought to advance the approach by employing an empirical research program borrowing from, and modifying where necessary, the epistemological and methodological insights of rationalist/problem-solving theory.[139]

The task that the initial proponents of the epistemic community approach set for themselves was an ambitious one. Advancing an ontological position that "... embraces historical, interpretive factors, as well as structural forces, explaining change in a dynamic way," [140] and doing so via a rigorous empirical research program had been – and continues to be - an elusive goal for these IR theorists.

Peter Haas and his colleagues have been at least partially rewarded in their enterprise if one judges success by whether or not an approach is used by other

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[138] Interestingly, Peter Haas participated in the seminars that led to the development of Goldstein and Keohane's book, which followed Peter Haas' initial work on epistemic communities (Goldstein and Keohane 1993 p. 11). Moreover, Goldstein and Keohane acknowledge the epistemic communities approach as both an important contribution to their own thinking on ideas and further as key 'transmission belts' for institutionalizing ideas in world politics (Goldstein and Keohane. 1993: p. 14). However, they take the view that the epistemic communities' approach is an incomplete representation of the impact of ideas on world politics. They note (Goldstein and Keohane 1993: p. 11) that "... [I]t is worthwhile for purposes of causal analysis to distinguish ideas that develop or justify value commitments from those that simply provide guidance as to how to achieve preferred outcomes." They characterize the epistemic communities' approach as providing insights that are limited principally to the latter. The task taken up by their book is related primarily to the former.

[139] That this was the specific goal of the earlier epistemic communities' analysts is acknowledged in the introduction to the groundbreaking special issue of *International Organization* edited by Adler and Haas: (1992: p. 367).

[140] Adler and Haas (1992 pp. 369-70) state that they seek to "...adopt an ontology that embraces historical, interpretive factors, as well as structural forces, explaining change in a dynamic way."

analysts. Epistemic communities have been employed to examine a wide array of issues, both in international relations as well as in other areas of enquiry.
Introduction of the term 'epistemic community' to IR theory is generally credited to John Ruggie.[141] Ruggie acknowledges that his use of the concept was inspired by Michel Foucault, who himself had been influenced by German philosophers like Weber and Habermas, and also by Durkheim's exploration of what he described as '*mentalities collectives.*'[142] To analysts in this tradition, human life is not focused singularly on the playing out of power relationships between individuals driven by rational calculations of utility. It also comprises "… webs of meaning and signification"[143] which have a profound impact on human interaction.

To Ruggie, an 'episteme' – which lies at the heart of each epistemic community – is:

> "… a dominant way of looking at a social reality, a set of shared symbols and references, mutual expectations and a mutual predictability of intention. Epistemic communities may be said to consist of interrelated roles which grow up around an *episteme*; they delimit, for their members, *the* proper construction of social reality.[144]

Suggested in the last clause of Ruggie's definition is the notion that members of epistemic communities are not neutral in their views. They have an agenda and press it via what Brown, borrowing from Foucault, refers to as 'hegemonic discourse.'[145] Hegemonic discourse constructs a 'regime of truth' through which events, and debates about them, are filtered.[146]

Ideas consistent with the hegemonic view are acknowledged and incorporated into an epistemic community's evaluation of events. Views that are incompatible – Foucault refers to these as 'subjugated knowledges'[147] – are discredited. So, as Brown indicates, "... a regime of truth goes further than agenda setting - it defines and endorses acceptable language, symbols, modes of reasoning, and conclusions." [148]

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[141] While introduction of the term 'epistemic community' to IR analysis is credited in this dissertation to Ruggie, principally because he was the first to use the perspective as a central feature of analysis and do it in a theoretically rigorous way, epistemic communities have been discussed in the social sciences for a number of years. Peter Haas mentions in a footnote in one of his earlier examinations of epistemic communities (Haas 1990 p. 221 FN 21) that he has drawn his understanding of the perspective from a series of analysts, including Holzner and Marx, Foucault and Thomas Kuhn. He proceeds to assess each of the definitions employed by these writers against Robert Merton's four imperatives for a scientific community (universalism, communism, disinterestedness and organized skepticism), borrows from each and adds his own insights to create a definition that has been used in many of the analyses that followed.

[142] For a more complete explanation of inspirations for Ruggie's use of the term, see: Ruggie (1998).

[143] Ruggie (1998 p. 184).

[144] Ruggie (1998 pp. 569-570).

[145] Brown (1997: p. 255).

[146] Brown (1997: p. 255).

[147] Brown (1996 p. 255).

Epistemic communities are therefore not value neutral. They are powerful 'transmission belts' specifying terms of reference and the proper language for debate[149] as well as enabling the goals and preferences of their members to dominate and discredit contending perspectives.[150]

As with debates in IR theory generally, and as is also evidenced in the literature on constructivism – where 'radical' and 'conventional' variations have been identified - there are often differences in emphasis for adherents to a single perspective. The literature on epistemic communities also features these kinds of variations – and they relate specifically to the focus of analysis as well as commitment to epistemology and methodology.

Issues of dominance, the transmission of ideas, and the subjugation of competing perspectives via hegemonic discourse are emphasized by 'critical' proponents of the epistemic community approach. These analysts tend to operate more at the systemic level of analysis and favour an interpretivist epistemology. Examples include Whiteneck's tracing of the influence of an epistemic community that drove the adoption of liberalized trade in the 18th century and the impact it had on the economies of Europe,[151] Brown's assessment of the influence of U.S. libertarianism in the contemporary world economy,[152] Beeson's similar treatment of dominant ideas in the Asia-Pacific economy, [153] and Ruggie's examination of the Westphalian system of states. [154]

Epistemic communities are also utilized by analysts in a less abstract manner employing a positivist epistemology. These examinations tend to focus on specific policy issues in international relations and other fields of enquiry rather than fundamental system change. Examples include Verdun on the impact of the Delors Committee on European Monetary Union,[155] Kapstein on central bankers,[156] Wright on European arms control,[157] Haas on Mediterranean pollution control,[158] Fry and

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[148] Brown (1996 p. 255).

[149] In referring to this notion of a special language for debate, Cox (in Cox with Sinclair 1996: p. 94), references Vico's notion of a 'mental dictionary.' A mental dictionary is a "... set of common concepts, with which one is able to comprehend the process of 'ideal eternal history,' or what is most general and common in the sequence of changes undergone by human nature and institutions."

[150] Sebenius (1992 p. 325) takes this perspective further by arguing that: "... an epistemic community can be understood as a special kind of de facto natural coalition of 'believers' whose main interest lies not in the material sphere but instead in fostering the adoption of the community's policy project."

[151] See Whiteneck (1996).

[152] See Brown (1997).

[153] See Beeson (1996).

[154] See Ruggie (1998).

[155] Verdun (1998).

[156] Kapstein (1992).

[157] Wright (1998).

[158] Haas (1992).

Hochstein on intelligence communities,[159] Peterson on whaling [160] and Thomas on ecological epistemic communities influencing US domestic policy deliberations.[161]

Clearly, the epistemic community approach has been used by a wide range of writers to examine a variety of issues since Adler and Haas first brought the concept to the broader attention of the IR community of scholars. This is at least partly attributable to their efforts to clarify the definition of 'epistemic community' and advance a research program that seeks to test the concept against specific case data.

Adler and Haas's characterization of 'epistemic community' both builds on and refines earlier efforts to clarify the concept. They posit that an epistemic community represents a shared set of ideas and beliefs, as well as a commitment to a common policy project, by a group of international 'experts' who exert influence on a state's policy-making process under conditions of uncertainty. By virtue of their status as experts, members of epistemic communities are able to help define the terms of policy debate and participate in filtering the evidence to be weighed in deliberations. By doing so, epistemic communities are able to influence the policy development process both within, and between states.

The definition for epistemic community provided by Adler and Haas has been widely debated in the literature. Interestingly, some critics[162] judge it too rigid, thus making it a difficult hurdle for a group to cross if it is to be identified as an epistemic community,[163] and others find it too loose. For example, Jacobsen notes that by the standards of Adler and Haas, the Central Intelligence Agency is probably an epistemic community.[164]

Moreover, whether an epistemic community exists or not is a 'contestable judgment' made by outside observers.[165] Rarely do members of a group under examination identify or promote themselves as belonging to anything like an epistemic community. Instead, they can be expected to deny it as acknowledgement might suggest potential ulterior motives and allegiances that would not serve them well in managing relationships and careers within their own governments.

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[159] Fry and Hochstein (1993).

[160] Peterson (1992).

[161] Thomas (1997) is an interesting venture as it is not in the field of international relations. Rather, it is in the area of U.S. domestic public policy. This demonstrates that the concept of epistemic community is finding interest in fields other than IR.

[162] There are a number of other criticisms of the approach. Both Jacobsen (1995: p. 103) and Susskind (1995: p. 74) question the normative content of the epistemic communities' perspective. To Jacobsen (1995: p. 103), it is a model "… of elites, by elites and for elites"– thus serving to perpetuate inequities and occlude alternative points of view. Others (Wright 1998) suggest that epistemic communities are epiphenomenal and at best represent intervening rather than independent variables, and that the Realist perspective on its own explains policy outcomes better.[162]

[163] See Verdun (1998: p. 6) and Wright (1998). However, Wright's problem with Haas' perspective on epistemic communities could be driven more by the practical issues that he faced in his own research. For example, based on a single questionnaire distributed to 153 officials, of whom only 19.6% responded, Wright concludes that the Haas perspective on epistemic communities fails to offer a compelling explanation of European arms control. With that level of response, it would be difficult to sustain any explanation.

[164] Jacobsen (1995 p. 301).

[165] As Raustiala notes (1997: p. 495), an epistemic community is "… an analytical construct imposed by an observer, rarely self-defined or formally organized."

Despite these criticisms, the principles articulated by Adler and Haas for an epistemic community to be in operation provide a very useful starting point and will be used in the examination of the case study that follows.

To reiterate, an epistemic community must:

- Be an identifiable group;
- Have a shared set of beliefs and ideas;
- Have a level of expertise that is widely acknowledged and operates to allow the group to influence both policy makers and the policy-making process; and
- In fact influence the policy-making process

As mentioned above, critics of the approach suggest that there is little to distinguish this 'epistemic community' identified by Adler and Haas from other kinds of groups such as lobby groups, advocacy groups, NGOs or other competing takes on like-minded individuals pressing a common policy project.

While this is an issue to be discussed in greater detail in the analysis that follows, it is possible in a preliminary sense to suggest that while some of the alternative characterizations offered for what epistemic communities purport to explain – for example, interest groups – can share many epistemic community attributes, there remain significant differences.

For example, while an interest group may be identifiable, have a shared set of ideas along with expertise, as well as an influence over the policy–making process, it generally does not operate in the policy-making process in the same way as an epistemic community does. Policy makers usually regard interest groups as advocating a position based on a political preference and subsequently it is relegated to being one choice among many. If an interest group succeeds, it is generally because its argument is persuasive with policy-makers and is also politically popular.

Epistemic communities are generally not perceived by decision-makers to be freighted with the same kind of 'political' baggage as interest groups. The epistemic community position is advanced by acknowledged experts as 'scientific' and therefore above the political fray. Consequently, the view favoured by the epistemic community is difficult to challenge by advancing another, potentially equally viable, perspective. It is the unassailability of its views, coupled with the mantle of scientific expertise and impartiality, as well as access to decision-makers and the decision-making process, that affords the epistemic community a level of influence over policy-making that most interest groups would envy.

Epistemic Communities and the Foreign Policy Process

Radaelli credits Adler and Haas with introducing three areas of focus that illuminate how epistemic communities can influence the state foreign policy development process.[166] They are: uncertainty, interpretation and the institutionalization of ideas.

The issue of uncertainty is key. Turbulent conditions,[167] an apt description of contemporary world politics, create ambiguity about policy choices, which in turn impedes 'rational' decision-making. [168] Under conditions of uncertainty, politicians responsible for a state's foreign policy-making are required on a daily basis to weigh options on issues as diverse and complex as monetary, environmental and trade policy as well as international justice, peace and war – matters that many are ill-equipped, yet expected by the electorate and media, especially in Western democracies, to manage well.

Turbulence is also fuelled by the intensification of globalization[169] coupled with the dismantling of bureaucratic policy infrastructures resulting from the dominance of the neo-liberal economic agenda for much of the last decade.[170]

Consequently, decision-makers have turned increasingly to 'experts' to assist them in framing agendas[171] that clarify state interests and suggest practical ways forward. Experts also play an essential role in helping design the specific policies required to advance the agenda once set, and further to implement and defend it once it becomes policy.[172]

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[166] Radaelli (1995 p. 165). Verdun makes a similar point (1998 p. 5).

[167] See Rosenau (1990).

[168] See Haas (1990 p. 350); Verdun (1998 p. 5) and Wright (1998 pp. 59-60).

[169] This position is advanced by Peter Haas (1992 p. 12).

[170] Canada is a case in point. A decade ago, most governmental departments, both at the federal and provincial levels, had policy staff as a significant component of their complements. With the deficit-cutting agenda of the 1990s, many departments either no longer have policy groups – or, if they do, it is at a significantly reduced level of support. Instead, the responsibility is shared across departments via central agencies, provided for under contract by consultants or foisted on industry groups, NGOs and others.

[171] Whiteneck (1996: p. 2) describes the agenda-setting influence of epistemic communities as follows: "During the agenda setting phase of world politics, global problems are defined, clarified and prioritized. Epistemic communities perform this task for the global political society. In a situation of uncertainty, they define the new problems faced by states and use their expertise to outline possible solutions. Without the capacity to coerce cooperation through the use of economic or political force, they exercise influence through the exchange and diffusion of ideas."

[172] Haas (1990: p. 350) describes the need for politicians to rely on expert advice under turbulent conditions in the following passage: "These questions [on matters of foreign policy] are particularly puzzling in technical issues that pose low probability but high-risk outcomes. Traditional search procedures and policy-making heuristics are impossible, and specific state interests may be hazy. Under such circumstances, information is at a premium, and leaders, in order to attenuate such uncertainty, may be expected to look for individuals who are able to provide authoritative advice, on whom to pin the blame for policy failure or simply as a stop-gap measure to appease public clamor for action."

This is not to suggest that by relying on the advice of experts, decision-makers cede their authority to make policy.[173] On matters of significant political salience – war and peace, for example – political decision-makers guide the policy process to a much greater degree. In these examples, decisions hinge less on the technical details that epistemic communities' manage best and more on 'political' judgment. Consequently, politicians are afforded a clearer line of sight resulting in greater certainty about decisions taken.

Even in these cases, though, experts can wield influence. Given the proliferation of complex linkages between sets of issues, governments are often wary of committing quickly and definitively to decisions that may affect other matters over the course of an uncertain future.[174] Members of epistemic communities can exploit decision-maker apprehensiveness by advancing preferred agendas that they then support with their epistemic community colleagues in other countries as well as in the media, where they are increasingly being tapped to appear as 'expert' commentators.

The second element of Haas' view of epistemic community identified by Radaelli as crucial to gauging their influence over the policy-making process is 'interpretation.'

Haas reasons that experts selected to interpret events and provide advice do so with their own "… vision of reality and … notions of validity."[175] These views – which the epistemic community pitches as non-ideological, scientific fact - colour the epistemic community's interpretation of events and subsequently frame its counsel to decision-makers.

Like-minded experts share these socially constructed visions of preferred policy direction across borders, and often become involved in their implementation at home. This process, described by Haas as "institutionalization," coupled with interpretation are the methods via which epistemic communities have their most salient impact on state foreign policy decision-making. Adler and Haas suggest that this influence is manifested through 'policy evolution.'

Policy evolution has four phases:

- Policy innovation
- Policy diffusion
- Policy selection; and

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[173] Raustiala (1997 p. 507) notes that epistemic communities are likely to have the most influence in: "… situations where international commitments are complex and impinge on central domestic policy arenas and where 'high politics' are not at stake – in short, much of the cooperation of today and arguably, of tomorrow."

[174] Haas (1992 p. 13) points out that: "Without the help of experts, they [decision makers] risk making choices that not only ignore the interlinkages with other issues but also highly discount the uncertain future, with the result that a policy choice made now might jeopardize future choices and threaten future generations."

[175] Haas (1992 p. 21)

- Persistence[176]

Adler and Haas contend that epistemic communities influence policy innovation by, first, advising the state on which issues to intervene as well as the terms under which the issue will be engaged and debated. Second, they define a state's interests in managing the issue. Third, epistemic communities set standards for charting progress as well as providing advice on necessary course corrections along the issue's life cycle.[177]

By asserting positions during the innovation phase of policy evolution, epistemic communities have a significant influence over the foreign policy agenda a state selects and how it is then pursued. There are any number of issues a state can face on the foreign policy front. Some are generated exogenously – and others endogenously. Some a state has no choice but to confront – and others it can choose to signore. Epistemic communities assist governments to sort through the welter of foreign policy issues active in the international environment and provide counsel on appropriate responses.[178]

Epistemic communities also play a key role in the process of policy diffusion. If it were not for the efforts of epistemic communities to transfer policy innovations to others – both domestically and abroad [179]- policy innovations would "… remain confined to a single research group, a single international organization, or a single national government and would therefore have no structural effects."[180] With the imprimatur of expertise, an epistemic community can act to diffuse policy preferences – and discredit contending perspectives – via, *inter alia*, conferences, in international negotiations, by providing advice as consultants to both specific governments and to international organizations and through appearing in the media.

The media is becoming a particularly important channel for policy diffusion by epistemic communities. One has only to tune-in to CNN, MSNBC or Fox News during an important international event to witness a cavalcade of so-called experts from a variety of institutions who clearly share a perspective on an issue, likely have regular contact via academic fora and symposia, read and write for the same publications, potentially consult to, or are in, government, and have a vested interest in pressing a policy project. While not all of these experts can be considered as belonging to epistemic communities, some of them certainly are – and they use their access to the media to further the agenda of the particular epistemic community to which they belong.

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[176] See: Adler and Haas (1992 p. 373)

[177] Adler and Haas (1992 p. 373)

[178] Adler and Haas (1992 p. 375) suggest that: "By offering expert advice and framing the context, the epistemic communities influenced policymakers expectations, and this in turn influenced their behaviour."

[179] Adler and Haas (1992 p. 379) note that: "Epistemic community members play both indirect and direct roles in policy coordination by diffusing ideas and influencing positions adopted by a wide range of actors, including domestic and international agencies, government bureaucrats and decision makers, legislative and corporate bodies, and the public."

[180] Adler and Haas (1992 pp. 378-379)

Epistemic communities can also frame a context for policy debate – though this can be mediated by a number of factors. Political and other variables have a significant impact on whether the ground is fertile for an epistemic community to plant and then germinate policy advice with political decision-makers. In many ways, timing is everything in this phase of policy evolution. For example, if a government is in electoral difficulty or a domestic crisis is taking the attention of elected officials, the ability of an epistemic community to press a foreign policy agenda is restricted.

It may also be the case that political conditions favour the introduction of a foreign policy project by an epistemic community. If a crisis abroad forces a government to examine its foreign policy positions on key issues, an epistemic community can use the opportunity to press its policy preferences. So, as with politics generally, timing is an important factor determining whether an epistemic community will be successful in lobbying its agenda.[181]

Once new policies become institutionalized, they can be difficult to dislodge. Moreover, via processes such as 'learning,' new policies can often have a viral quality, spreading from country to country and across issue areas. This is the phase of epistemic community influence that Adler and Haas refer to as "policy persistence."

The most important engine for policy persistence is 'organizational learning.' In their references to organizational learning, Adler and Haas take a different position than the earlier neofunctionalist work of Ernst J Haas and John Ruggie which positioned learning as a key driver for change in world politics.[182] Adler and Haas regard learning as:

> … [A] process that has to do more with politics than with science, turning the study of political process into a question about *who learns what, when, to whose benefit, and why*. Our concern is with

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[181] As Adler and Haas indicate (1992 p. 383): "… with policy selection the ability of epistemic communities to nudge decision makers into new patterns of behaviour was also dependent on timing. The cases show that it was much easier for politicians to accept a community's policy approach after military or economic conditions changed sufficiently to minimize the costs of compliance with the approach."

[182] On their debt to Ernst Haas' and John Ruggie's earlier work, as well as the efforts of cognitive analysts, and on the point of departure for their own take on organizational learning, Adler and Haas (1992 p. 370) state the following: "We are indebted to the neofunctionalist and cognitive approaches, and in studying epistemic communities we follow the trail pioneered by Ernst B. Haas and John Gerard Ruggie. In contrast to neofunctionalism, however, we do not seek to explain the processes by which authority is transferred from the nation-state to international institutions as problems become more technical and amenable to the creation of scientifically based common meanings. And we are not merely interested in analyzing scientific and political styles of thought as they combine to create various types of world order."

> reasoning, but not with the purely rational forms of reasoning that are assumed by much of the rational choice and neorealist traditions or with the forms that are taken as a teleological taproot for much of the neofunctionalist work. While we focus on rationality, we are agnostic about the form that rationality will take. By rationality, we mean an internally consistent pattern of reasoning. It need not be logico-deductive.[183]

Adler and Haas' position on learning is an interesting one. While their view that learning operates as an engine for policy change and persistence does not differ markedly from neofunctionalists and others, their perception that epistemic communities bring a 'rationality' to the policy development process via injecting 'reasoning' into policy discussions is an important distinction. By adopting this stance, Adler and Haas position a politically contextualized 'rationality' at the fore of reflective/critical analysis.

Clearly, Adler and Haas' notion of 'reasoning' is a different understanding of rationality than employed in the normal science of IR literature – which views rationality principally as an ahistorical/apolitical cost/benefit calculation. What 'reasoning' offers as an alternative is the potential to advance a research program blending the strengths of the positivist epistemological position with those of the interpretivist epistemology of reflectivist/critical analysis. It thus becomes possible to examine ideas and their impact on foreign policy decision-making in a manner that provides for the testing of hypotheses and cumulation of data via case studies where epistemic communities may be at work. It is to this topic that attention will turn in the next chapter.

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[183] Adler and Haas (1992 p. 370)

Chapter Three

Methodology

Methodological Pluralism

The purpose of chapter 3 is to discuss the methodological approach to be used in this dissertation to examine whether or not an epistemic community existed that influenced the outcome of the Canada-US beer disputes. This investigation will have a positivist orientation in that the focus will be on generating hypotheses to test against case study data with the intention of developing conclusions linking specific ideas and actors to political outcomes.[184]

While this sounds simple enough, linking intersubjective phenomena like ideas, culture, ideology or epistemic communities to foreign policy outcomes via a positivist epistemology presents a significant theoretical challenge. Both Adler and Haas and Goldstein and Keohane have broached it most directly by calling for what Adler and Haas term 'methodological pluralism.'[185]

Embracing methodological pluralism creates the possibility for a research program that bridges longstanding divides between rational/problem-solving and reflective/critical theory on ontology, epistemology and methodology to yield "... a set of constrained conditions under which order is possible ...."[186] In so doing, analysts capture salient insights from both perspectives and address some enduring deficiencies.

In adopting a 'methodologically pluralistic' approach, both Adler and Haas and Goldstein and Keohane are clearly cognizant of the criticisms likely to be raised by adherents to both the rationalist/problem-solving and reflective/critical perspectives.[187] Nonetheless, they conclude that the alternative is for the field to remain mired in what Goldstein and Keohane have referred to, and what has been referenced in Chapter 2 of this dissertation, as a '... purgatory of incompatible epistemologies."[188] Advancing IR theory, then, requires taking some calculated epistemological and methodological risks.[189]

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[184] Goldstein and Keohane (1993 p. 11).

[185] Adler and Haas (1992 p. 367).

[186] Adler and Haas (1992 p. 367).

[187] In answer to a criticism they anticipated coming from the rationalist/problem-solving position, Adler and Haas (1992 p. 367) opine that: "Methodological pluralism and theoretical synthesis, which we take to be our strength, may nevertheless prevent us from achieving the level of parsimony often desired by international relations theorists."

[188] Goldstein and Keohane (1993 p. 26)

[189] Goldstein and Keohane (1993 p. 29) suggest that: "We do not demand methodological perfection. If we did, we would be studying voting behaviour or congressional roll calls instead of a project so murky as the role of ideas in foreign policy. But we do hope that a distinctive feature of this

A significant hurdle in theory that supporters of methodological pluralism must cross is to reconcile systematic social science analysis – that is, the generation of hypotheses to be tested via case studies and similar methods with the intention of isolating conclusions that can be applied to other cases – with the need to employ the interpretive methods required to examine evanescent phenomena like 'ideas.'[190]

The main challenge of course is that studying ideas is not as straightforward as tallying ships, tanks, GDPs and the like and attributing policy outcomes to the relative strengths of states in each of these areas. With ideas, analysts are forced to try and "...interpret what is in people's heads."[191]

Accordingly, the interpretive methods rooted in specific historical contexts favoured by the reflectivist/critical approach are judged by proponents of methodological pluralism to be better suited to this kind of analysis. Nevertheless, supporters of critical/reflectivist theory would naturally respond that the positivist epistemology and empiricism that methodological pluralism seeks to retain cannot be aligned with an interpretive orientation. Again, a precipitous plunge into the purgatory of incompatible epistemologies may appear imminent.

Goldstein and Keohane suggest that this may not have to be the case. They recommend an alternative method of inquiry that employs both descriptive and causal inference to reconstruct what actually happened during an event as the first step in a process that is ultimately focused on explanation.[192]

Researchers must sift through voluminous, often contradictory and incomplete records in an attempt to piece together a narrative that captures accurately key events of a specific case study. As documentary evidence is generally either incomplete, unavailable due to confidentiality restrictions or, as is often the case in studying issues like trade negotiations, not memorialized in written form, inferences must be drawn to fill gaps in the data. It is rarely the case in studying international relations that this would not be the situation. Goldstein and Keohane differ from much of the rest of the field, however, in that they acknowledge the issue and

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particular attempt to examine the role of ideas will be its methodological self-consciousness and the care with which both descriptive and causal inferences are made."

[190] Haas (1990 p. 9) also acknowledges this issue and settles on a similar resolution: "Basically, I anchor my approach on this bet: the knowledge available about 'the problem' at issue influences the way decision makers define the interest at stake in the solution to the problem; political objectives and technical knowledge are combined to arrive at the conception of what constitutes one's interest. But since decision-makers are sentient and self-reflective beings, the conceptualization cannot stop here because decision-makers take available knowledge into account, including the memory of past efforts to define and solve 'the problem.' They know that their knowledge is approximate and incomplete. Being aware of the limits of one's knowledge also influences one's choices. Being critical about one's knowledge implies a readiness to reconsider the finality of what one knows and then to be willing to redefine the problem."

[191] Goldstein and Keohane (1993 p. 27)

[192] See Goldstein and Keohane (1993 pp. 27-29)

suggest that they are drawing inferences from the evidence available to address gaps that may exist in the record.

They suggest further that inference plays an additional role in delineating the impact of specific ideas on policy decisions. Establishing co-variation between ideas and outcomes demands that evidence be sifted using the methods of a skilled reporter or detective to isolate plausible explanations. Explanatory scenarios must be informed by the best evidence available as well as compelling guesswork – not unlike what occurs in writing a feature article in a newspaper or solving a murder mystery.

A further screen for isolating causation is to consider seriously explanations that fit more with the weighing of material capabilities than with the impact of ideas on policy outcomes. Goldstein and Keohane discuss this approach in the following passage:

> It could be argued, for example, that the political and economic dominance of the United States after World War II led both to the prevalence of capitalist ideology in the West and to the creation of liberal political and economic institutions. If, as this argument claims, hegemony alone explained all the variation in the form of postwar institutions, any alleged causal connection between capitalist ideology and liberal institutions would be spurious.[193]

To meet this objective, Garrett and Weingast suggest that arguments related specifically to material capabilities must be 'taken seriously' in any examination that purports to position ideas as key determinants of foreign policy outcomes.[194] Goldstein and Keohane agree and thus each of the case studies featured in *Ideas and Foreign Policy* takes care to consider an explanation focused on rational calculations about material interests alone before testing the impact of ideas on events.

Epistemic Communities and the Canada-US Beer Disputes

The 'methodological pluralism' of Goldstein and Keohane and others presents a potentially compelling framework for examining whether an epistemic community affected policy outcomes in the Canada-US beer dispute. If it can be shown that an epistemic community existed that had a determinative impact on events in the beer dispute, value will be derived both in terms of augmenting the prevailing statist explanation for events in Canadian foreign policy as well as obtaining policy-relevant information from the beer disputes that may potentially be applicable to other cases.

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[193] Goldstein and Keohane (1993 p. 29)

[194] Garrett and Weingast in Goldstein and Keohane (1993 p. 203).

To test this proposition, the following hypotheses will be considered:

1. The events of the Canada-US beer dispute can be explained primarily by considering rational calculations about the material interests at issue for the two countries.

Should hypothesis (1) prove insufficient to explain events, the following two hypotheses will be deployed:

2. An epistemic community comprised of trade officials from Canada's Department of Foreign Affairs and International Trade and the United States Trade Representative's Office was operating during the Canada-US beer disputes.
3. This epistemic community had a determinative impact on policy outcomes in the Canada-US beer disputes.

As recommended by Goldstein and Keohane, an explanation focusing on material interests will be taken seriously. In fact, it will be tested as the **first** explanation of the events under consideration. That is, this theoretical examination of the Canada-US beer disputes will be conducted with the intent of 'proving' that material interests alone explain adequately what occurred and why.

If this explanation proves inadequate, only then will the hypotheses focusing on epistemic community be deployed to see if they help complete the picture.

A Note on Sources

The historical case study data against which the hypotheses above will be tested consists of primary source material drawn from, *inter alia*, the Brewers Association of Canada archives, documents from the Government of Canada and the Government of the United States, the EC and its members states and various provincial and state governments. In addition, private brewing companies in both Canada and the United States and their consultants produced correspondence, memoranda and analyses that provide interesting insights into events. Much of this material has been unavailable for academic study until now.

Moreover, the disputes were covered by both the popular press and trade journalists in Canada and the United States and by a number of Canadian investment analysts specializing in the beer sector. These materials will also be used to help both reconstruct events and provide a flavour of the prevailing political environment in which the disputes occurred.

Further, a number of memoirs and academic analyses have been produced about Canada-US relations in general, and trade relations specifically, covering events before, during and after the Canada-US beer disputes. These will be culled to derive information that could aid this investigation.

The Interviews

A series[195] of detailed interviews were conducted for this dissertation with Canadian federal and provincial government officials, US trade negotiators, representatives of the Canadian brewing industry and trade consultants to the various parties involved, including:

- Canada's Department of Foreign Affairs and International Trade
- The Brewers Association of Canada
- The Brewers of Ontario
- Office of the United States Trade Representative
- Liquor Control Board of Ontario

Specific interview subjects were chosen because they participated actively in the management of the dispute.

The following questions were asked of each interviewee to uncover evidence that might confirm the existence of an epistemic community and isolate what impact, if any, it had on events. A number of additional questions were posed to clarify the historical record.

Interview subjects are not identified as several of them either remain in government service or have dealings with government that could be affected if their views were attributed. Many of the interview subjects participated only on the condition that their identities remain confidential. That request has been honoured.

On the issue of conducting research to isolate whether epistemic communities exist and have an impact on policy outcomes, Haas suggests that analysts undertake the following tasks:

- Identify community membership
- Determine the community members' principled and causal beliefs
- Trace their activities and demonstrate their influence on decision-makers at various points in time
- Identify alternative credible outcomes that were foreclosed as a result of their influence
- Explore alternative explanations for the actions of decision-makers.[196]

The questions featured in the interviews have been organized to provide data to engage the first three of Haas' categories. Items four and five are related more to examination of the null hypothesis. In addition, as mentioned above, some questions were posed with the purpose of clarifying the historical record.

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[195] Twelve interviews were conducted either in person or via telephone. Each interview was approximately two hours in duration.
[196] Haas (1992 p. 34)

While many of the interview questions will be shown to have elicited information that has relevance to all of the categories mentioned above – for example, it is difficult to differentiate questions that isolate community membership from those designed to ascertain community members' beliefs - it is important that they be organized in categories so that they can be engaged by readers more readily.

Identify Community Membership

- Did the Canada's federal government have ultimate control for the dispute settlement process or was it really shared with the provinces and the brewing industry?
- What role do you think that elected officials in Washington and Ottawa played in the dispute? Was its course more or less plotted and implemented by bureaucrats who had their own interests and objectives in the outcome?
- Trade negotiators have a great deal in common as they do the same kinds of work and often sit across from each other over many different sets of negotiations. Do you think that this has an impact on the negotiating process and the outcomes achieved?

Determine the Community Members' Principled and Causal Beliefs

- What is your view the issue of open borders to trade?
- What policy orientation should government's adopt for industries lacking comparative advantage in the world economy?
- Are some forms of trade protection acceptable for companies that may not be competitive internationally?
- Is it important for a special trading relationship to exist between Canada and the United States?
- Would it ever be the case that Ottawa could – or should – risk affecting its trade relationship with Washington by protecting a Canadian industry from potentially damaging US competition?
- What was your view of the Canadian beer business before the MOU (Memorandum of Understanding) between Canada and the US?
- Did you feel that provincial liquor boards unfairly penalized US brewers?
- Do you feel that free trade has been a positive influence in terms of its impact on Canadian industry? How does this compare with your perspective at the time the CUSTA (Canada-US Free Trade Agreement) was signed?
- Given the historical differences in how the Canadian and US beer industries developed, which were driven largely by different approaches taken by governments – for example, the requirements in both that a brewer had to be resident to be able to sell there – do you feel that it was proper for the Canadian business to be required to adjust as quickly as it was by the GATT (General Agreement on Tariffs and Trade)?
- What is your view on the ability of brewers at the time to be able to mobilize political sympathy amongst Canadians to aid their cause?

- Did Canada have a legitimate case under international trade law for sustaining provincial liquor board practices?
- Did you feel that there was a 'social policy rationale' for provincial liquor regulations or were they just a device designed to protect Canada's brewers?
- Do you feel that the outcome was ultimately a positive or a negative one for Canada's brewers?
- Do you feel that measures designed to promote bottles in the Canadian marketplace were intended to protect the environment – or, were they simply discriminatory measures intended to shelter Canadian brewers from US producers, who sell primarily in cans?
- Is the minimum price in place in most provinces a legitimate social policy measure or is it designed only to protect Canadian brewers from having to deal competitively with lower-priced US imports?
- Do you think it was proper for beer to be exempted from the CUSTA? Why do you think it was done?
- Did you feel that the brand loyalties of Canadian consumers would substantially protect Canadian brewers from US price competition?
- Do you believe that the US market is less restrictive than the Canadian market?
- What impact did you think that implementation of the MOU would have on the Canadian beer business?
- Do you think that the Canadian beer industry was sacrificed for the higher purpose of keeping the Canada-US trading relationship intact?
- Did you believe the BAC's (Brewers Association of Canada) claims that the Canadian beer industry would cease to exist as we knew it with the implementation of free trade with the US in the beer sector?

Trace Their Activities and Demonstrate Their Influence on Decision-makers at Various Points in Time

- Why was it that the US chose to limit its retaliation to Ontario-produced beer only? And why did Ottawa choose to respond only against Stroh and Heileman?
- Did you see Beer II as a serious exercise intended by Canada to address real impediments to Canadian competition in the US market? Or, was it simply a ploy by the Canadian brewers to help give them some cards to play in the negotiation process?
- What do you think would have been the best way to deal with adjustment for the Canadian brewing industry?
- What would have been your reaction to a proposal that Canadian barriers would not be removed until US restrictions on foreign beer were also addressed? Why would Canada not get this guarantee before insisting on changes in the provincial market?
- If Heileman and Stroh were in such dire financial shape, why did the US press as hard as it did?

- Why did the US choose to continue its commitment to the MOU even after AB (Anheuser-Busch) objected?
- Why did Canada permit the Section 301 to proceed in the GATT rather than insist that it be managed through the FTA dispute settlement process?
- Do you think Canadian policy-maker's regarded the Section 301 as a useful development that could be leveraged to drive the dismantling of IPBs (Interprovincial trade barriers) in Canada? Did Canada's negotiators encourage the USTR (Office of the United States Trade Representative) to press the case?
- Do you believe there was a *quid pro quo* between Free Trade negotiators in Canada and the US that in return for beer being exempted from the FTA, Canada would not resist the US pursuing a Section 301 at the GATT?

It will be recalled from the preceding discussion on reflective/critical theory that for interpretive methodology to be properly deployed the issue of historical context must be engaged. Chapter 4 will set out the historical development of the beer industries in Canada and the US and set the stage for the disputes between the two countries that were to follow. The case study itself, including an analytical discussion of the explanatory capabilities of the null hypothesis, as well as the two hypotheses designed to test the epistemic community concept, will then follow.

Chapter Four

Laying the Groundwork for the Disputes

Early History to Prohibition

The history of Canada's economy features a complex interplay of capitalists, regulators, unions and other stakeholders pulling and hauling to balance wealth creation with often competing notions of the public interest. Some segments of the economy have attracted more notoriety in this churn than others. Examples such as publishing, the oil industry and the airline sector come to mind. However, if assessed via a barometer that accounts for longevity, level of regulatory oversight, rents charged, and any number of other metrics that could reasonably be selected to gauge government interest and involvement, few could challenge Canada's brewing industry.

The Canadian brewing industry has, for most of its existence, been both a benefactor and a victim[197] of government intervention. Its existence has been nurtured by governments (particularly provincial governments) coveting high paying union and salaried jobs,[198] tax revenue[199] and the attendant benefits of having a purchaser of significant quantities of value-added goods in a provincial jurisdiction (i.e. malting barley, bottles and cans, transportation services, advertising, local media). The brewing industry has also been affected negatively by the obverse consequences of these same impulses (again, provincial governments actively preventing the development of a national brewing industry in order to retain breweries and all of their positive spin-offs) as well as an ongoing concern about the potentially deleterious social impacts of beverage alcohol.

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[197] In a very interesting admission, Canada's federal government describes in a 1984 study of the Food and Consumer Products Industries Branch of the Department of Regional Industrial Expansion (Baird 1984 p. 25) the negative influence that government has had on the brewing industry. "The current role of Canadian governments vis-à-vis the industry is a restraining one; they regulate closely, they tax and in general, say what industry cannot do. The industry is used very much in the sense of a 'cash cow'; that is, as a source of funds to exploit as long as possible in order to finance other efforts."

[198] For example, the Food and Consumer Products Industries Branch of the Federal Department of Regional Industrial Expansion noted in a 1984 study of the Canadian brewing industry that (Baird 1984 p. 26): "Not only is the number of people employed important, but also the quality of this employment. The types of skills employed directly in the brewing industry are diverse. The Brewers Association of Canada recently did a survey on the different employee requirements in breweries; one brewery listed close to 150 different job classifications. These covered the spectrum from brewers and engineers, specialists in marketing, advertising, export sales, purchasing and transportation to display staff, sales analysts, microbiologists, laboratory technicians, medical doctors and nurses, accountants, chefs and food service personnel to drivers and mechanics. In one plant alone there were four persons with doctorate-level degrees employed at the time of the survey. This would appear to indicate that the breweries provide employment opportunities for highly qualified personnel at good wage rates and they are thus attractive industries for any area of the country."

[199] Ottawa has noted the interest of both the federal and provincial governments in freighting the brewing industry with a heavy tax burden. See: (Baird 1984 p. 17): "Consideration may well have to be given to the old adage that one should take care to not 'kill the goose that lays the golden egg.' The increasing tax burden on the products is not only a source of funds but also a market factor and, beyond that, an influence on export viability, tourism and employment. Moreover, while the demand has, to date, been reasonably price inelastic, the current interest in making one's own beer and generic beer may indicate that cheaper sources are being considered by the consumer.'

The earliest examples of regulatory intervention in Canada's brewing industry[200] can be traced to the creation of the first commercial brewery in the country established by Intendant Jean Tallon in 1668.[201] Desrochers notes that to assure the success of Tallon's enterprise, the government of the day:

> … restricted the importation of wine to a maximum yearly quota of 1800 barrels, and that of spirits to 400 barrels. The wholesale price of a barrel of beer was set at 20 pounds, excluding the container, and a stein of beer retailed at six 'sols'. Brewers were given a ten-year guarantee of protection ….[202]

There are a number of striking similarities between these early regulations and the rules and restrictions that were to be at issue in the trade disputes that will be examined in the case study discussion that follows.

The next significant development in the history of alcohol regulation in Canada[203] came as a result of the efforts of Temperance forces pressing both Canada's federal government and the provinces to stamp out alcohol consumption altogether as, in the view of the Temperance movement, alcohol consumption had a negative impact on women, families and society in general.[204]

The efforts of the anti-alcohol lobby produced the Canada Temperance Act in 1878. The Act permitted communities to determine by vote whether or not to allow the sale of any alcoholic beverage within a municipal jurisdiction.[205]

While the Canada Temperance Act produced some significant commercial restrictions on the Canadian brewing industry, they paled in comparison to the next significant legislative impact that the Temperance movement was to have. Prohibition was introduced during World War 1. And by 1919, all provinces had regulatory measures in place that effectively halted the growth of the legitimate beverage alcohol sector in Canada.[206]

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[200] There is evidence of even earlier examples of more general alcohol regulation in Canada. The Dominion Brewers Association (1948 p. 75) notes that "The sale of alcoholic beverages in what is now the Dominion of Canada has been subject to regulation by its successive governmental regimes since the year 1663, when an 'aret' imposed penalties on those continuing sale to the Indians in New France."

[201] See BAC (1997 p. 69), Desrochers (1968), and Dominion Brewers Association (1948) for general overviews of the early history of brewing in Canada.

[202] Desrochers (1968 p. 14)

[203] There were some minor regulatory developments in the interim period. The Dominion Brewers Association (1948 p. 75) notes that: "Throughout the colonial period under British and French Imperial rule, government ordinances dealt with local option, licenses, penalties for infractions, and other phases of manufacture and distribution."

[204] For a history of this period see: Smart and Osborne (1996)

[205] BAC (1997 p. 69)

By the end of the 1920s, Canada's experiment with Prohibition ended. It was repealed in most provinces within a year or two, though there was significant lag in some jurisdictions. For example, Prince Edward Island did not repeal Prohibition until 1948.[207]

The early history of Canada's brewing industry mirrored closely these various regulatory changes. If legitimate production was permitted, the industry flourished. The opposite was the case when consumption was outlawed.

When it was permitted to operate as a legitimate sector of the economy, Canada's brewing industry was relatively unfettered by specific commercial regulation. If there were limits on industry growth, they were associated more with the primitive technology then available to transport a fragile liquid over great distances in bottles or kegs. Consequently, small firms competing for a share of specific local markets characterized Canada's brewing industry in its infancy.[208]

As with most sectors of the economy – especially consumer packaged goods – consolidation is eventually required to develop economies of scale, create competitive discipline in the marketplace and grow profitability.[209] The Canadian brewing industry is no exception. The first major steps toward consolidation actually occurred before Prohibition, when in 1909, eleven Montreal and Quebec City Breweries merged to form National Breweries. The merger created a dominant player in that marketplace. This pattern was to be followed in other regions across the country.

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[206] Quebec was the least enthusiastic supporter of Prohibition. It lasted only a year in the province, and during that time, wine and beer consumption was permitted.

[207] However, some provinces repealed Prohibition by allowing counties and municipalities to determine for themselves whether they were to be 'wet' or 'dry'. As Doug Fetherling notes in Donaldson and Lampert (1975 p. 53): "Ontario, for instance, enacted Prohibition in 1916, and though it repealed the legislation in 1927, some counties remained without legal drinking until the late 1940s."

[208] Frank Roseman (1968 p. 9) points out that: "… plant sizes and locations are the resultant of transportation costs, population patterns, production functions and factor costs…."

[209] As Desrochers (1968 p. 16) indicates: "The brewing industry has, over the last sixty years, been the scene of a number of mergers, found necessary for the survival of the industry. At one time, almost every locality of any importance had its brewery. The pressure created by the constant increase in the cost of raw materials, labour, taxes and other expenses, forced brewing companies to merge, thereby creating larger but more efficient corporations. The mergers resulted in increased productivity and lower average production costs which, in turn, allowed the price to the retailer to be kept at a reasonable level in spite of the regular increase in the special taxes on beer." That this was part of the rationale for consolidation is no doubt accurate. However, Sherbaniuk (1964) and Roseman (1968) argue that there was a more nefarious motive in some instances. They suggest that there was ample evidence produced by a Canadian Breweries Limited Combines investigation to demonstrate convincingly that a key motivation for consolidation was the need to suppress rampant price-cutting and other business practices then destroying brewer profitability.

Prohibition had the effect of both encouraging and limiting consolidation in the brewing industry. Acquisition-driven consolidation was attenuated in many instances as the market atrophied and the cash flow required to purchase competitors did as well.[210] But, consolidation resulted anyway as poor economic conditions meant that many marginal players were forced to abandon the business altogether. The outcome was fewer and larger brewers in the marketplace.

Post-Prohibition

As Prohibition ended,[211] the consolidation trend was reversed for a short time as many smaller startup brewers entered the market intending to exploit what they hoped would be a sudden increase in demand for beer. However, for most, the market demand they anticipated never materialized given the poor general economic conditions of the Depression[212]gripping Canada in the 1930s. Consequently, the economics driving consolidation before Prohibition were even more so in evidence in the years following it.

The character of post-Prohibition regulatory management of Canada's alcohol industry – and by extension, the beer sector – is probably unique in the world. As a 1987 Woods Gordon analysis of the Canadian beer industry notes:

> For most products, trade measures are implemented only at the national level in most countries, and are designed to affect competition between domestic products and imports – mainly to help create a 'level playing field.' The Canadian brewing industry is affected to some extent by such national trade measures. However, it belongs to a unique group which is also affected by interprovincial trade measures which are aimed at out-of-province producers, whether Canadian or foreign.[213]

The mixed federal-provincial jurisdiction over Canada's beer industry stems from the 'shared powers' concept that lies at the heart of Canada's constitution. In Section

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[210] Though, as is well known in the history of the Canadian brewing business, a number of Canada's brewers were able to remain afloat by brewing a watered-down beer permitted for sale in some provinces and also by breaking Prohibition restrictions in the United States by smuggling beer across the border.

[211] Canada's federal government ended its interest in the Prohibition experiment with the promulgation of the Importation of Intoxicating Liquors Act in 1928.

[212] As Roseman (1968 p. 7), in his description of post-Prohibition Ontario, notes: "The long interruption in the sale of alcoholic beverages and the renewal of sales also had an effect on the structure of the brewing industry. When the Liquor Control Act was passed in Ontario in 1927 it was very difficult for prospective entrants to estimate what demand would be. As a result, aggregate rated capacity in the industry was far in excess of sales. Moreover, the miscalculation of the brewers was further aggravated by the onslaught of the Depression. Thus the structure of the industry … was strongly influenced by exogenous forces to the industry."

[213] Woods Gordon (1986 p. 7).

91 of the Constitution Act of 1867, Canada's federal government is provided "...constitutional authority to control import and export measures across national or provincial boundaries."[214] As beer moves across international borders, and across Canadian provincial borders, Canada's federal government is empowered by the constitution to regulate these transactions.[215]

At the same time, the provinces are granted authority by Canada's constitution to regulate the alcohol business at a local level. As Canada argued before the GATT Panel brought by the EC (European Communities) contesting provincial liquor board practices, this provincial constitutional authority, coupled with the promulgation in 1928 of the Importation of Intoxicating Liquors Act, has created a powerful authority for the provinces to also regulate the alcohol trade:

> All liquor boards in Canada are created by provincial statutes and their monopoly position with respect to the supply and distribution of alcoholic beverages within their provincial border is based on provincial legislation. The provinces are constitutionally empowered to enact such legislation under section 92 of the Constitution Act, 1867. In particular in the heads referring to 'Property and Civil Rights' and 'Local' legislation. [216]

The Importation of Intoxicating Liquors Act (IILA) was promulgated in 1928 by Canada's federal government to clarify roles and responsibilities of both provincial and federal regulatory authorities in the post-Prohibition environment, and by so doing assure that the provinces actively managed the alcohol industry to guard against the abuses that Prohibition had been intended to address.[217]

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[214] Canada – Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies. *General Agreement on Tariffs and Trade Basic Instruments and Selected Documents. Thirty-Fifth Supplement. Protocols, Decisions, Reports 1987-88 and Fourty-Fourth Session.* Geneva: The Contracting Parties to the General Agreement on Tariffs and Trade. June 1989. Report Adopted on 22 March 1988. (p. 4045). This report will be referred to as the EC Panel Report hereafter.

[215] Canada's federal government has created additional legislation to govern the brewing industry that goes beyond its authority to regulate trade and commerce. For example, as Eckel and Goldberg (1993 p. 3) note: "The federal legislation consists of the Broadcasting Act, which controls advertising, the Food and Drug Act, which regulates alcohol content; Importation of Intoxicating Liquors Act, which controls imports, Canada Temperance Act, which allows local options for restricting production and consumption; and the Excise Act, which has regulatory and revenue power."

[216] EC Panel Report (pp. 4044-4055). Canada went on to (EC Panel Report p. 4070) argue that this provincial authority had been upheld by the Canadian courts. "Canada recalled that the provinces had full authority to set up the boards and to control their pricing and retail policies and that the Canadian courts had upheld these powers. Canada argued that liquor was a commodity like any other and that provincial marketing boards controlling internal transactions had been upheld on many occasions (e.g. Home Oil Distributors Limited v. AGBC 1944)." Sherbaniuk (1964 p. 127) makes a similar argument in discussing a merger case related to Canadian Breweries Ltd.

[217] As Irvine and Sims (1994 p. 3) suggest: 'The reasons frequently given for restrictions on the production and sale involve social objectives such as promoting temperance, minimizing health costs,

To operate under this authority, each province created its own legislative architecture that, *inter alia*, gave life to provincial crown agencies called 'liquor boards' or 'liquor corporations.' The liquor boards in turn developed operating policies and practices to regulate the marketing, distribution, sale and consumption of alcoholic beverages. And, as much as each province is unique, so are its rules to manage the alcohol beverage trade.[218]

Because of these new rules, the business environment within which Canada's brewers operated changed significantly. Before Prohibition, although there was clearly some regulation of the business, Canada's brewers operated for the most part in a *laissez-faire* milieu with change driven largely by economics.

In the aftermath of Prohibition, the twin capitalist disciplines of supply and demand were fettered severely as provincial governments took steps via regulation to ensure that brewing remained in each of their specific jurisdictions and that the rents charged to the industry were maximized.[219]

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and reducing accidents and addiction.' Frank Roseman (1968 p. 124) outlines the rationale for the Province of Ontario in the following passage: "Ontario left prohibition, but not without a long look backward. The Liquor Control Act of 1927, following the lead of other provinces, was designed to give the government complete control over transactions within the province. Control towards what end? A summary answer: the generally-recognized evils of overindulgence in alcoholic beverages were to be prevented. Would-be consumers were required to obtain a permit without which they could not make purchases. Evidence of deterioration of an individual's estate or damage to his home life because of the consumption of alcoholic beverages were grounds for suspension of his permit. As an illustration of prevailing attitudes, families holding a permit were refused 'relief' (welfare payments) during the depression." A similar perspective was offered for control by the Advisory Committee on Liquor Regulation in the Province of Ontario (Report of the Advisory Committee on Liquor Regulation 1987 p. 24): "In an ideal society, there would be no need for regulation of the manufacture, sale and service of alcoholic beverages. If alcohol were a consumer commodity like soup, special regulations would be unnecessary. However, we live in an imperfect world and we must recognize that alcohol is not an ordinary substance. The fact that it is an enjoyable commodity does not obviate its potentially destructive consequences for individuals and society in general."

[218] Many of the restrictions placed on the brewing industry were not in legislation – but, rather in the operating policies of individual liquor boards. As the Conference Board notes (1990 p. 7): "Investigation of the barriers to interprovincial trade in beer revealed that the restraints, although effective, did not reside, for the most part, in the explicit wording of specific regulations. Rather the barriers more often take the form of well-established practices that have been shaped over the years as the industry evolved." Irvine and Sims (1994 p. 4) echo this view in the following passage: "Such requirements [rules governing the liquor trade] have not always been laid down in the form of legislation. Rather, the power derived from the Intoxicating Liquors Act [sic] enabled the provincial governments to demand local production – under the threat of legislation."

[219] Roseman (1968: p. 265) develops this position in the following passage: "The problem is that the regulation of the alcoholic beverage industry was not designed for the reasons familiar to economists. The pressures for regulation have been far removed from the question of economic efficiency. Certainly cheapness and plenty have not been the object. If anything, the opposite has been true. For more than one hundred years governments at every level have been subjected to pressures for and against prohibition, for and against controls of consumption. These have been the dominant issues, and the concerns of the governments have been consistent with them. The performance of the brewing industry must be traced to these one-sided concerns." Eckel and Goldberg (March 1993 p. 4) discuss the taxation regimes created by the provinces to maximize rents taken from beer in the

Moreover, each province adopted measures that prevented out-of-province and foreign brewers from gaining a foothold in their specific markets. This 'beggar thy neighbour' approach had a significant impact on the evolutionary trajectory of the Canadian brewing sector.[220]

The variety and complexity of regulations introduced by the provinces to manage Canada's brewing industry are remarkable in both their breadth and attention to the smallest details of manufacturing, marketing, sales and consumer consumption. A brief depiction of some of the more prominent controls implemented by liquor authorities to govern Canada's beer business follows.

The Regulatory Network

Each liquor board in Canada used its authority to implement regulations to manage, *inter alia*, the following aspects of the alcohol trade:

- **First receipt** – The IILA directs each province to operate as the authority for importing alcoholic beverages within its jurisdiction. To manage this function – described as 'first receipt' - each liquor board invested in warehousing operations to receive all foreign product so that it could be sampled, tested and inspected to ensure conformity with product standards, labeling requirements and related measures. It is important to consider that 'importing' is defined differently for alcoholic beverages than for most other commodities. Importing usually means bringing an item manufactured in a foreign country into the Canadian stream of commerce for sale. However, given that the IILA designates individual provinces as importing authorities for alcoholic beverages, the relevant stream of commerce is not Canada – it is the specific provinces. The result was that out-of-province manufactured beer was treated the same (or, in some instances, worse) as foreign manufactured product. For performing the first receipt function, each province added a 'cost of service' to the retail price of the product. Consequently, each province also had a "...strong fiscal interest in effective

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following passage: "At the provincial level there is enormous diversity in the methods of beer taxation. The provincial governments raise considerable revenue through the mark-up on beer sold by their liquor boards and through license fees to other sellers of beer. Provincial sales taxes are often applied on top of previously marked up beer prices, providing a further source of revenue."

[220] Roseman establishes this point in the following passage (1968 p. 266): "The principle on which the liquor board acts were based was implicit in the establishment of stores owned by the government: [prior to Prohibition, sales were largely 'on-premise' and were driven, not unlike the situation that exists in much of Europe even today, by 'tied-house' relationships. That is, suppliers 'forced' distribution by becoming financially tied to saloons where drinking was permitted] the profit motive, which leads private firms to stimulate consumption, should not be permitted to operate. The same principle may be identified in the provisions of the liquor acts which placed all forms of sales promotion – including advertising, packaging and the use of sales representatives – under the control of the liquor control boards.... [P]rovincial regulation was designed to prevent the stimulation of demand. Hence the heart of the legislation and the day-to-day regulations by the liquor control boards were in contradiction to what would be a widely-recognized goal for most consumer goods – namely, cheapness and plenty".

control of … beer until it can be counted and the appropriate mark-up imposed"[221] which influenced how the first receipt function was managed.

- **Retailing and distribution controls** – It was in this area that the widest variation occurred between the provinces. The range of options for retailing beer for off-premise consumption was remarkable.[222] While domestic beer was sold through the government monopoly channel in all provinces except Quebec (and Alberta, with privatization in 1993), there were other outlets available. For example, domestic beer could also be sold in producer stores, grocery stores, and by licensed vendors in Newfoundland; by grocery stores in Quebec; by producer stores in Ontario and through licensed vendors (e.g. hotels) in Manitoba, Saskatchewan and British Columbia. Foreign and out-or-province producers did not have access to these channels. This is an important consideration given that the non-government stores retailed by far the greatest amount of beer volume. For example, in Ontario, over 95% of beer was sold through Brewers Warehousing, in Manitoba, over 90% was sold in cold beer stores.[223] Consequently, lack of access to these alternative retail channels for foreign brewers was to become a central issue in the beer disputes.

- **Listings** – While practices varied somewhat from province to province, generally any beer supplier wishing to sell its product in a province first obtained a 'listing' from the provincial liquor authority. Each liquor board determined whether the product should be listed based on an assessment focusing on criteria such as quality, price, potential consumer appeal, relationship to other products of the same type already listed for sale in the province and performance in other markets. If the listing was granted, maintaining it became subject to certain performance criteria – i.e. minimum sales quotas. Products that did not perform were 'de-listed' and no longer sold in the province.[224]

- **Minimum prices and markups** – These taxation measures were implemented to fulfill a number of objectives. First, there was a revenue maximization interest for the provinces.[225] By their behaviour over the years – evidenced by the high taxation levels for beer sold in Canada as compared to other countries[226] - it is clear that the provinces were driven to derive the maximum revenue it was politically feasible to capture from the sale of alcohol. Second, given a widely held belief that the price of alcohol was an important determinant of demand, the provinces implemented taxation measures intending to maintain high retail prices for the express purpose of curbing immoderate consumption. This is the 'social policy' rationale that was later to be fiercely debated during the beer disputes.[227] Lastly, though it is not stated explicitly in the written policies of any provincial government, it is difficult to argue that higher mark-ups imposed on foreign products were not designed to both protect in-province brewing facilities and motivate foreign and out-of-province brewers to invest in infrastructure within the province to avoid the markup penalty.[228]

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[221] BAC internal memo (1 September 1988). It should be noted that not all out-of-province beer was treated the same under first receipt. If a manufacturer had an operating plant within the province it was not required to have its product physically received at a government warehouse. Product could be moved straight from a brewer's out-of-province shipping dock to the province's retail channel with a paper transaction. The rationale was that there was a physical facility *in situ* that permitted inspectors to perform first receipt quality checks if need be. Moreover, there was an existing business within the jurisdiction that could be penalized should a violation occur. Consequently, in-province manufacturers were able to avoid substantial charges for out-of-store cost of service.

[222] A range of other rules and procedures related to sales, marketing and consumption on-premise existed in all provincial jurisdictions. However, these tended to be the same for domestic and foreign suppliers (with the exception of, for example, a differential minimum price on draft in B.C.) and therefore were not raised to any significant degree in the beer disputes between Canada and its trading partners.

[223] BAC internal memo (1 September 1988).

[224] For a description of the various provincial listings practices operating at the time of the trade disputes, see: EC Panel Report . (pp. 4047-4048).

- **Environmental controls** – The provinces implemented a number of regulations and taxation policies to ensure that the package of preference for beer in Canada was the bottle. Measures included differential deposits, special levies and waste diversion standards. As with the social policy rationale used to justify differential taxation measures which kept the price of foreign products at a higher level than Canadian beer, provincial governments presented an environmental rationale for preferring the bottle over the can. For example, bottles, which were returned for deposit, could be used up to a maximum of 15 times, while cans, which also carried a deposit and a differential levy in some jurisdictions, were used once and then either recycled or diverted to landfill. But, as with differential taxation policies, there was also a protective element to the environmental measures. Most Canadian brewers had invested in bottle breweries, and were in fact very efficient operators in that package format. US brewers were primarily in the lower cost and more easily transported aluminum can. Consequently, bottle preferences operated to suppress the natural competitive advantages that US brewers enjoyed over Canadian brewers on packaging. This would become a significant issue in the beer dispute.[229]

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[225] As the EC GATT Panel notes (EC GATT Panel pp. 4047-4048): "The mark-ups being imposed, in part, for fiscal reasons, constitute an important source of revenue for provincial governments."

[226] On average, over 50% of the final retail price for beer sold in Canada is made up by taxes. Only two jurisdictions in the world are higher – Norway and Finland. For specific comparisons see: BAC (1997 p. 576)

[227] As one of the US trade officials noted in an interview for this dissertation (Dissertation interview: "There is no question that the social policy rationale was a smokescreen for protection. To say that it was anything else was a joke." While Canadian brewers at the time mounted a significant effort to buttress the social policy rationale, some now confess that there were difficulties with the argument. As one representative from a Canadian brewer interviewed for this dissertation noted (Dissertation interview): "There was no acceptable social policy rationale. We knew it was a protective measure that we were trying to defend."

[228] Differential mark-up policies are described in the EC GATT Panel Report (EC GATT Panel Report p. 4046) "Most Canadian provinces have had a long-standing policy of differential mark-ups applied by the provincial liquor boards being frequently, but in degrees which vary from province to province and with respect to the type of alcoholic drink, higher than those applied to domestic products." Differential mark-ups were the prime component of what evolved into provincial policies that required brewers to have manufacturing facilities in a province in order to sell product there. As the Food and Consumer Products Industries Branch of the Department of Regional Industrial Expansion described (Baird: 1984 pp. 5-6): "Significant provincial barriers exist to protect their own brewers. For example, provincial regulations require that a company must have a brewing establishment in the province before its products can be displayed in retail stores and this is the reason why regional brands are generally available only in the province where they are brewed. Although 'out of province' beers can be sold if a special surtax is paid to the appropriate provincial authority, few brewers avail themselves of this avenue since the tax usually cannot be passed on to consumers."

Pre-trade Dispute Consolidation

Just as they adjusted to the market conditions that prevailed during Prohibition, Canada's brewers responded to these various regulatory measures by shaping business models and strategies that embraced the advantages, but also the weaknesses, provided for by the regulatory environment.[230] The most obvious manifestation was in the way that consolidation and rationalization[231] was to occur after Prohibition.[232]

Instead of the brewing industry developing along national lines – which occurred in many other countries once it became technologically feasible to transport beer across great distances[233] – Canada's brewers, even those with national aspirations, developed as regional enterprises.[234]

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[229] A US trade official noted in an interview for this dissertation that (Dissertation interview): "There is no doubt that bottle preferences were an impediment to trade. We looked at a number of studies to examine the effectiveness of Ontario's environmental levy. For example, I think we were able to prove that more waste is created by bottle caps than by aluminum cans. Our view was that the US system was just as effective in terms of protecting the environment – but, without the same level of discrimination." Another US trade official interviewed for this dissertation indicated that (Dissertation interview): "It was very dubious to us that the packaging restrictions had as their primary rationale saving the environment. The initial impetus may have been waste diversion. But, over time it became an economic measure." Again, as with the social policy rationale, some Canadian brewers now acknowledge the US argument. As one Canadian brewery representative noted in an interview for this dissertation (Dissertation interview): "The environmental levy was essentially a discriminatory measure intended to protect Canadian brewers."

[230] In some instances, they added their own 'industry' measures to augment the provincial rules. As Sherbaniuk (1964 p. 161) notes in his study of the investigation undertaken by Combines regulators of Canadian Breweries Limited: "Canadian Breweries promoted and consummated such restrictive arrangements throughout its 29-year history; the company urged other brewers into agreements and castigated recalcitrants who violated them. Prices were fixed; pacts were made, broken and renegotiated. Yet throughout this same period the brewing industry was supposedly being 'regulated' by provincial authorities."

[231] As Irvine and Sims (1994 pp. 8-9) note: "This trend toward rationalization has been taking place for some time. In 1955 there were 55 brewing plants operating in Canada and only two of these had capacities in excess of one million hectolitres per year. By 1981 there were 41 plants, 8 with capacities above one million hectolitres per year. By 1992 there were 32 conventional breweries with 7 having capacities in excess of one million hectolitres and 4 in excess of 2 million hectolitres."

[232] For more detailed discussions of this period see: Irvine and Sims (1994 p. 7) and Jones (1967).

If a brewer desired to enter a particular provincial market, it would not behave as it would in a less regulated environment. In the latter circumstance, a brewer could hire an agent to supply sales and potentially marketing support and simply ship the product. This strategy presented far less risk – and, provided it was successful - could lead either to an acquisition or the construction of a facility in that province.[235]

However, with the provincial regulatory system operating as it did in Canada, if a brewer sought access to another provincial market it generally did so by acquiring an existing brewery with the intention of first avoiding, and then taking advantage of provincial regulatory policies.[236]

By the mid-1980s, just prior to the trade disputes, three national brewers, which together accounted for 95% of the Canadian market for beer, had emerged from the consolidation process – Labatt Brewing Company Limited, Molson Breweries of Canada and Carling O'Keefe Breweries. A number of smaller regional operators shared the remaining 5% of the market.[237]

While the comfortable symbiotic relationship[238] that existed between brewers and the liquor boards produced a profitable national brewing industry in Canada, it was also inefficient, under-scale,[239] highly balkanized, and ultimately vulnerable to foreign competitors that were not similarly constrained. Proof of this assertion is evident on examining the brewing sector that developed south of the 49th parallel.

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[233] Despite Canada's brewers adopting state of the art transportation technology, transporting a product that is essentially bottles and water across great distances to widely dispersed concentrations of people will always be a challenge. As Woods Gordon notes (1986 p. 2): "Other market forces, including the widely dispersed and low density Canadian population, and the dominance of refillable bottles, have made transportation costs a further factor in limiting the ability of Canadian firms to centralize production facilities."

[234] As the Brewers Association of Canada notes (1991 p. 2): "...the industry evolved from cottage enterprises to local manufacturing operations, many of which were later knitted together into national companies with plants and operations in most provinces across the country. But as a result of policies put in place by governments, the evolution stopped short of developing an integrated, multi-regional or national infrastructure."

[235] The rationale being that the costs of shipping and regulatory penalties could be saved by locating in the province rather than exporting from another location.

[236] As Wood Gundy (1995 pp. 18-19) notes: "...[I]nterprovincial borders were the driving force behind the consolidation of the Canadian beer market during the 1960s. In order to sell beer in another province the larger brewers acquired smaller, regional players, thereby acquiring distribution and a brewing facility, which was a necessary prerequisite to selling beer within a given province."

[237] A list of the smaller players is provided by Woods Gordon in the following passage (1986 p. 2): The remaining firms include the Atlantic-based Moosehead Breweries; Amstel, Northern, Upper Canada and Brick in Ontario; The Drummond Brewing Company in Alberta; and Pacific Western Brewing Company in British Columbia, as well as some smaller microbreweries and brew pubs.... [E]ach of the three national firms operates one or more breweries in every province except the Maritimes. In total, the three majors have 28 plants: three in each of Newfoundland, Quebec, Manitoba, and Saskatchewan; four in both Alberta and BC; six in Ontario, and two in the Maritimes."

[238] An apt description of this relationship is set out by JA Sherbaniuk (1964 p. 171): "The Canadian brewing industry was a picture of concerted action among multi-plant oligopolists – at the brewers', or producer's level – operating under some measure of restraint imposed at the retail level by provincial liquor boards operating as monopsonists."

The Evolution of the US Brewing Industry

The United States brewing industry shares a number of similarities with that of its northern neighbour – but it also has many striking differences. For similarities, the early histories of the businesses in Canada and the US are virtually identical.

It will be recalled that in Canada the brewing industry arrived with some of the earliest colonists and then expanded across the country to service individual markets.[240] Given the limited ability of brewers to transport bottles and liquid over great distances to service a widely dispersed population, small, locally-focused breweries proliferated across the country.

The same technological hurdles affected the growth dynamics of the brewing industry in the U.S.[241] Moreover, as in Canada, a period of consolidation and rationalization was set in motion as technology developed to manage transportation issues.[242] Baron describes this period in the following passage:

> Though the bulk of the [US] breweries at that time (and in 1910 there were still over 1500) were small, local enterprises, making all their own deliveries by horse-drawn wagons, it was the few large, highly mechanized factories, with merchandising chains extending beyond their own neighborhoods or towns,

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[239] The Federal Department of Industry, Science and Technology noted in its 1988 profile of the Canadian brewing industry (1988 p. 3) that: "The economies of scale available to the industry are not being achieved since provincial policies requiring breweries to operate a brewing facility in each province prevent the establishment of national-scale plants. The current minimum plant scale necessary for cost-minimization in beer production is about four to five million hectolitres per year. Canadian plants produce from 250,000 to 2.8 million hectolitres annually – well below the cost-minimization point."

[240] McGowan (1997 p. 36) notes that: "The production and distribution of beer and distilled spirits was one of the earliest American commercial activities. It is interesting to note that even Puritan leaders generally agreed that beer was a wholesome and nourishing beverage …."

[241] For further information on the early US beer industry see: Baron (1980), McGhan (1991) and McGowan (1997).

[242] As McGhan (1991 p. 248) notes: "The invention of the metal keg and the steel beer can in 1935 created important new marketing and distribution opportunities for large brewers. Metal kegs and cans were significantly cheaper to ship than glass bottles because they weighed less, they were easier to cool, and they blocked more of the damaging light that sometimes ruined bottled beer in transport. Cans were also easier to stack and store and were not recyclable, eliminating the costly return trip. The range of economical distribution of the big brewers increased dramatically as a result. The largest firms – the shipping brewers – complemented their augmented product line with expanded wholesale distribution systems and investments to decrease transportation costs." Given the regional nature of the Canadian brewing business, these technological innovations did not have as dramatic an impact.

> that controlled the major part of the market. Formerly, each brewer had known the exact confines of his market and been able to maintain it with relatively little competition: the consumer simply was not offered so many choices. But the development of a national web of railroads – improved communications in general – had drawn the whole country closer together; and the great technological advances within the brewing industry itself had made it feasible for individual brewers to look for customers farther afield. This era was marked, then, by the emergence of the national brewer – a new concept in the industry, with its technical paraphernalia and merchandising innovations, constituted an immense step forward.[243]

The 'step forward' to which Baron refers is an essential point of difference with the Canadian market. Whereas in Canada provincial regulations prevented brewers from developing national scale for production and marketing and sales efforts, in the United States the beer industry could look to the entire country as a potential market. This had an enormous impact on the relevant development of the beer industries in Canada and the US, and was the key reason for the competitive chasm between Canadian and US brewers at the start of the beer wars.

This is not to say that regulatory developments had no impact on the US marketplace. In many regards, the US brewing business has been regulated just as heavily as the Canadian brewing sector. For example, the US federal and state governments established via legislation and regulation, *inter alia*, control states and open states, residency requirements for licensing in many states, taxation regimes that favoured domestic over foreign brewers, and most importantly, Prohibition, with the three-tier system being created on its repeal.[244] Nevertheless, an important distinction concerning regulations between Canada and the US is that governments in the United States did little to prevent the evolution of a national brewing business in that country.[245]

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[243] Baron (1989 p. 257)

[244] The three-tier system is referenced by Scotia McLeod (1993 p. 61) in the following passage: "A great mystery of the US beer business is the famous three-tier distribution system. Beer is handled by middlemen – wholesalers and distributors – whose role is enshrined in state alcoholic beverage legislation."

[245] McGhan (1991 p. 230) points out that there were regulatory limits that constrained the development of a national US beer market – but they tended not to be related to states behaving in the same manner as provinces had in Canada. "The American brewing oligopoly developed because of restrained demand and regulatory pressures until the Second World War forced brewers to avoid price and advertising competition and to accelerate adoption of cost-saving technologies. When regulatory constraints were lifted and wartime shortages were relieved, several large regional brewers expanded into other markets." Similar arguments are developed by McGowan (1997 p. 35), Irvine and Sims (1994 p. 6) and Woods Gordon (1986 p. 4).

Comparison of the US and Canadian Regulatory Regimes

It is essential that the key regulatory and competitive differences between the Canadian and US businesses be outlined to assist in explaining the nuances of some of the main negotiating points at issue in the case study that follows. An efficient way to examine the distinctions between the two jurisdictions is via the summary chart that follows. What will become clear on reviewing these data is that although the process of brewing is virtually identical in Canada and the United States, once the beer is transported from the brewery to the marketplace and comes under the scrutiny of regulators, the products become very different in many important respects.[246]

Table 2. Comparison of key regulatory and competitive dimensions of the Canadian and US brewing sectors

Feature	US	Canada
Market	National	Regional
Taxation levels	About CDN$6.00 per litre between federal, state and local levels. Translates into 18.5% of the average retail price of a six-pack of cans in the US.[247]	Averages CDN$29.00 per litre in Canada between federal and provincial taxes and markups. This translates into 51% of the average retail price in Canada.[248]

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[246] As Baron (1980 p. 337) notes in tracing the development of the US business: "The process of brewing itself, except for the standards of uniformity made possible by yeast culture and pasteurization, has changed very little; the great changes have concerned what happens to the beer *after* it has been manufactured. Once the construction of the modern brewhouse and bottling plant was set at the beginning of the twentieth century, progress, though extensive, has concerned mechanical details, always aimed at reducing costs simultaneously with the increase of production. This is a continuous process, to which engineering ingenuity is contributing all the time."

[247] Scotia McLeod (1993 p. 61).

[248] Scotia McLeod (1993 p. 61). This difference in taxation levels on beer fuelled the cross-border shopping phenomenon in the category that occurred in the late 1980s. Cross-border shopping was a key concern of the Brewers Association of Canada (1991 p. 5). The BAC describes the issue in the following passage: "The wide differential in taxation rates, coupled with the easy access of a large portion of the Canadian population to US border communities, has encouraged the cross-border sale of beer to the detriment of both the Canadian brewing industry and government revenues. Consumers can purchase beer, including Canadian brands, from US retailers at significant savings. Conservative estimates put the loss in beer consumer expenditures in Canada at $250 million annually. This is likely to grow by as much as $100 million in the coming year as a result of tax increases in 1991."

Table 2 (con't). Comparison of key regulatory and competitive dimensions of the Canadian and US brewing sectors

Feature	US	Canada
Price	Set by individual companies freely. Segmentation into separate price categories. Overall, beer is significantly cheaper than in Canada.	Government controls pricing in most jurisdictions. Consequently, little segmentation into separate price categories, with the exception of a limited price segment in Alberta and BC.[249] Beer is significantly more expensive than in the US.
Distribution and retailing	Three-tier distribution. Retailing is for the most part open with a heavy concentration on supermarkets and convenience stores in many states.	Government and limited private retailing with exceptions including Brewers Warehousing in Ontario and grocery retailing in Quebec.
Varieties	Almost entirely a lager market/light beers are 25% of the total.	Canada mostly lager – but significant ale. Light beer is 13% of the total.

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[249] BAC (1991 p. 8) describes Canadian price segmentation: "Limited price competition has emerged over the past few years in parts of Canada. There is not a well-developed Canadian equivalent to the super-premium segment. Regular priced beers (e.g. Labatt Blue, Molson Canadian) make up virtually all of the market (including the estimated 20 percent represented by light beers) in Quebec and Ontario. In Western Canada (particularly British Columbia and Alberta) the popular-priced or discount segment now accounts for 25 percent to 35 percent, up from less than 5 percent in 1981, and has been fueled by low-priced US can imports. In Canada, imports accounted for 4 percent of the market in 1989, a fourfold increase over the last six years, (but this rises to over 20 percent if licensed brands are included)."

Table 2 (con't). Comparison of key regulatory and competitive dimensions of the Canadian and US brewing sectors

Feature	**US**	**Canada**
Package mix	Primarily aluminum cans (60%) and one-way bottles (24%). Refillable bottles are 5% of the market.[250]	Primarily returnable bottles – 72%.[251] There is a higher proportion of cans to bottles in the West.
Cost base	CDN$5 - $14 per hl lower than Canada (excluding marketing and sales).	CDN$5 - $14 per hl higher than in the US (excluding marketing and sales).
Malting barley	Purchase on the open market.	Forced purchase at the Canadian Wheat Board.[252]

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[250] Scotia McLeod (1993 p. 61).

[251] Scotia McLeod (1990 p. 11) notes that "Returnable bottles are a cheaper package format for the brewer than cans. A can presently costs the brewer about CDN$ 0.13 and is used once. A bottle may cost about CDN$ 0.18 and is used on average about 10 times [the Canadian industry estimates that bottles are in fact used 15 times] – while obviously some cost to collect, sort, wash, sterilize, and refill the bottle on each of its repeat trips, but much cheaper than the can." It is important to note that the Scotia McLeod analysis fails to mention that cans are far more efficient to run on a packaging line and cheaper to transport than bottles – both of which actually make it a much cheaper package in a scale brewery than bottles. Scotia McLeod further explores the issue of bottles vs. cans and develops a key insight – that is, the bottle vs. can debate in Canada is not really about one package format vs. another - it is about pricing. This point is made in the following passage (Scotia McLeod 1990 p. 11): "The creation of a strong returnable bottle preference is the optimal strategy for a brewer wishing to fend off a distant competitor. The brewers [that is, Canadian brewers] therefore prefer bottles for strategic and cost reasons. They have consequently priced their canned beer higher than bottled [aided by penalties in many provinces that force a preference of bottles over cans] and by a greater margin than would be required to offset any container cost differential. Thus, the higher retail prices for canned beer not only recover brewers' extra profit margin on cans, in addition to which they actively discourage the public from buying canned beer. The latter effect has been, one may surmise an important policy objective. A substantial affinity for canned beer on the part of Canadian beer drinkers is a key which would unlock the Canadian market for greater penetration by US beer."

[252] The BAC (1991 p. 5) notes that: "A further form of indirect and discriminatory taxation, is the requirement by Canada's federal government that domestic brewers purchase malting barley at artificially high prices set by the Canadian Wheat Board. This practice disadvantages Canadian brewers by approximately $25 million annually, and has an even greater impact on consumer pricing ($43 million) of domestic beer."

Table 2 (con't) Comparison of key regulatory and competitive dimensions of the Canadian and US brewing sectors

Feature	US	Canada
Scale	In 1990, Anheuser-Busch sold 95 million hls. of beer. Miller ranked second with 49 million hls. Average plant size in the US was 2.4 million hls.[253]	The total volume of the Canadian market in 1990 was 20 million hls. Average plant capacity was 730,000hls.[254]
Labour contracts	7 day operations	5 day operations
Raw materials	Significant vertical integration as well as purchasing efficiency related to scale.	Less vertical integration and reduced purchasing efficiencies as the businesses are of a smaller scale.
Brands	Small number of national brands.	A large variety of regional brands – few national brands.[255]

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[253] BAC (1991 pp. 8-9). Irvine and Sims (1994 p. 33) note that new breweries being built in the US were much larger than the average cited by the BAC: "The cost studies which have been undertaken for the Canadian brewing industry indicate that minimum efficient scale lies in the two to three million hectolitre range. Why then do we observe the newest breweries in the US with capacities in the range of ten to twenty million hectolitres? There are several reasons for this. First, there are major differences in the transportation systems, related to the density of the market, trucking costs and the use of cans rather than returnable bottles. Shipping costs are significantly lower in the US than in Canada because of the lower price of gasoline, and a less regulated trucking industry. In conjunction with much greater population densities, this means that the major brewers can build larger breweries and take advantage of the scale economies up to much higher production levels. While the increasing returns to scale may decline after three million hectolitres, they are clearly significant enough to promote the construction of plants with several times that capacity. The density of adjoining populations further makes it profitable to set up satellite canning/bottling plants to which beer is shipped in bulk from the mega breweries…. In Canada, in contrast, shipping costs are higher due to higher costs in the trucking industry and to the requirement that beer be shipped in returnable bottles. [The Conference Board of Canada (1990 p. 24) estimates that the per kilometer cost of shipping bottles is 'triple the cost of cans.']"

[254] BAC (1991 pp. 8-9.)

[255] Irvine and Sims (1994 pp. 34-35) describe the difference as follows: "… [An]… important distinction between the US and Canadian production structures is the multitude of brands/labels produced by each of the major brewers in Canada. In contrast, the US producers concentrate upon a very small number of brands…. The multitude of labels produced by the Big Two [Molson and Labatt] springs in large part from the fact that these brewers grew to their prominence by taking over small brewers. These latter had high local consumer loyalty to their brands. Thus, maintaining a long menu of labels for the major firms was seen as a way of maintaining their market share. This was therefore quite a different process from what has been observed in some other sectors, where dominant producers have sought to prevent entry by potential competitors, through multiplying their products."

Table 2 (con't) Comparison of key regulatory and competitive dimensions of the Canadian and US brewing sectors

Feature	US	Canada
Volume trends	Flat.	Declining.[256]
Worker productivity	Although wage rates are 20-25% higher, larger plant scale and more efficient technology (primarily related to a can preference) mean higher productivity than in Canada.[257]	Although average wage rates are lower, productivity costs are higher due to smaller plant sizes and less efficient technology (bottle preference vs. cans).
Exports	2.5% of total production. US brands either exported or under license in Canada represented 15% of the Canadian market.	12% of total production – mostly to the US.[258] Canadian brands had 1% of the total US market.[259]
Competition	While there was more competition than in Canada on price, the market tended to be dominated by one player – Anheuser-Busch – who as category leader could discipline competitors to its market preferences.	Dominated in the late 1980s by three players – Molson, Labatt and Carling-O'Keefe. Competition was driven less by price than by brand imagery developed through extensive marketing and sales efforts.
Capacity utilization	75%	85%
Tariffs on imports	CDN$ 0.15 per gallon.	CDN$0.08 per gallon.[260]

In comparing the US and Canadian brewing sectors along key regulatory and marketplace dimensions, it is clear that the Canadian business had had its development truncated severely by the provincial regulatory regimes. Nevertheless, these same regulatory conditions did create a very profitable Canadian brewing industry.

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[256] Scotia McLeod (1993 p. 61).
[257] Woods Gordon (1986 p. 2).
[258] Scotia McLeod (1993 p. 61).
[259] Woods Gordon (1986 p. 1).
[260] ISTC (Industry, Science and Technology Canada) Industry Profile (1988 p. 3). Woods Gordon (1986 p. 15) judges that, given its relatively negligible level, neither tariff had a significant impact on beer trade between Canada and the US.

US surplus capacity located in close proximity to Canada that could easily be shipped north of the border if regulatory conditions were to change.[261]

The advantageous cost base available to US brewers further elevated the concern of Canada's brewers about what the future could hold. Lower costs driven by economies of scale could eventually allow US brewers to sell beer in Canada at prices significantly below what Canadian brewers could hope to supply the market. Earlier US incursions into BC and Alberta had demonstrated that Canadians could be switched easily enough to US-brewed discount canned product if the price was low enough.

The threat of this kind of activity to Canada's brewers was not just the loss of market share to US beer. Of greater concern was the potential impact on Canadian profitability that could result from Canada's brewers chasing US discount beers in an extended game of tit-for-tat price-cutting.[262]

A final point that heightened concern for Canada's brewers was the flat US market for beer. It meant that if US brewers were seeking potential new volume to utilize excess capacity, it could be accomplished in one of two ways. The first was to take it away from competitors at home. However, as the history of the US post-Prohibition beer industry demonstrates, this was a very expensive, long-term proposition that is generally not successful.[263] The alternative is to source new volume from previously untapped sources, including other countries. For certain US brewers, seeking new volume in Canada was the more realistic of the two alternatives.

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[261] Scotia McLeod (1990 p. 19) establishes this point in the following passage: "…[T]he US brewing industry has total surplus capacity equivalent to more than three times the total Canadian market, and (more relevantly) some of this capacity is located in the northeast, north-central and Pacific north-west sectors of the US, well located to supply a significantly increased penetration of adjacent Canadian markets if it were to be achieved. Further, the proximity of many US breweries to Canada, their substantially lower unit production costs, and the generally lower profitability of US brewers compared with that of the Canadian industry, allow US beer to be sold in Canada at a discount rather than a premium to domestic Canadian prices." Woods Gordon (1986 p. 22) adds further credence to this concern in the following passage: "Based on interviews with market participants and knowledgeable observes [sic], the usable excess capacity [in the US market] is about 35 million hectolitres on average, or just over 15 per cent of the annual output of the industry. This estimate includes a mothballed $411 million (US), 12 million hectolitre plant built by Miller Brewing in Butler County, Ohio in 1983. The plant has never been used, having been built as a result of overly optimistic market growth and share projections." Woods Gordon goes on to say (Woods Gordon 1986 p. 25) … [I]n the peak season, the available US excess capacity represents close to 70 per cent of the average monthly sales of beer in Canada. Thus, even when adjusted for seasonality, and omitting capacity in outdated plants which have been shut down in recent years, it is clear that there is sufficient excess capacity to permit some US brewers to make sizeable inroads into the Canadian market, using existing facilities. With modest additional investment spending on equipment for existing plants, and by running the existing equipment for more than the current standard hours, it is likely that the US brewers could satisfy the entire Canadian market for beer if they so desired."

[262] Scotia McLeod (1990 pp. 22-23) develops this point as follows: "The penetration of low-priced US beer into Canadian markets has several effects in addition to the loss of sales by Canadian brewers: (1) If significant, it is likely to provoke a discounting response by the Canadian brewers; (2) It tends to push down some Canadian prices; and (3) It tends to change the traditional pattern of Canadian pricing, at some loss of revenue and margin to the Canadian brewers. To hurt the Canadian brewers' earnings significantly, US beer does not have to take a substantial share of the Canadian market. If its presence is sufficient to provoke the defensive reactions of the Canadian brewers in Alberta and BC, it will pull brewing profitability down towards US levels."

The two US brewers with the greatest motivation to explore opportunities north of the 49th parallel in the 1980s were Heileman and Stroh. However, they were not the first US brewers to look to Canada as a potential market for their products.

The first contemporary forays of US brewers into Canada for which there is some evidence occurred in the 1950s when a number of US brewers attempted to sell their products in Ontario. They faced a series of impediments to entry, which are described by Sherbaniuk in the following passage:

> For one thing, foreign brewers who wished to market their product in the province were required to pay Brewers' Warehousing a high handling charge per case. While the actual cost to Brewers' Warehousing of handling was 'in the neighbourhood of 30 cents a case – give or take a couple of cents.' Canadian brewers from outside of Ontario were charged 75 cents a case and American brewers $1.25.[264]

Despite these charges, a number of US brewers persisted in their efforts to try to enter Ontario. However, Brewers' Warehousing, Ontario's privately owned alternative to the government retail channel, owned at the time by Carling, Molson and Labatt, freighted US brewers with such an array of imaginative commercial penalties that the US brewers lost interest in exporting to the province.[265]

The loss of interest for US brewers in the Canadian market persisted for a number of years until another method for entry emerged – the licensing agreement. Rather than try to dismantle the Byzantine structures of the regulatory regimes operating in the various provinces to gain meaningful access to the Canadian market – and likely destroy its attractive profitability as a result – the larger US and Canadian brewers entered into licensing agreements to bring popular US brands to Canadian consumers. These deals were mutually coveted as Canadian brewers desired to both improve their capacity utilization by brewing US beer for the Canadian market and also gain the use of a number of attractive brands which Canadians had come to know either while on vacation in the US or via broadcast advertising that 'spilled-over' the Canadian border.[266] US brewers thought of it as a way to capture at least some margin from Canada, ultimately at very little cost or effort.

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[263] The only national US brewer that has been consistently successful in this endeavour has been Anheuser-Busch.

[264] Sherbaniuk (1964 p. 97).

[265] Sherbaniuk (1964 p. 98) recounts that "… certain United States brewers, e.g. Anheuser-Busch, Schlitz and Goebel, were prepared to pay the $1.25 a case in order to gain a foothold in the market. But, paying the service charge, it seems, was not enough. Brewers' Warehousing also demanded that the American brewers conform in every way to the Ontario method of bottling and packaging, e.g. using bottles of the same colour, size and shape as Ontario brewers. This was necessary, Brewers' Warehousing said, to avoid confusion in sorting out the empties returned by customers for refund of deposits. To circumvent this problem, the United States firms offered to use 'non-returnable' bottles. When Brewers' Warehousing still insisted that the American firms adopt Ontario-type bottles, the US brewers lost interest in the Ontario market."

However, mutually positive licensing arrangements[267] were not readily available for most second tier US brewers – although Stroh and Heileman did manage to secure minor licensing deals with Canadian partners. For Stroh and Heileman to address their competitiveness and capacity issues at home, they needed to be filling their own breweries, not Canadian facilities.

In addition, as the primary method of marketing for second tier US brewers at the time tended to be price, they were not able to support their brands as they normally would in the US given the strict pricing controls of the provincial liquor boards. All of this fuelled a desire to change the Canadian system.

Second-tier US brewers were not the only manufacturers of alcohol in the world to be frustrated by the Canadian regulatory regime for alcohol. European, Australian, and US distillers and vintners seeking new markets for their products found themselves to be similarly thwarted by Canada's provincial liquor boards. This mounting frustration culminated in a series of international trade interventions which brought revolutionary change to the rules governing the entire Canadian beverage alcohol sector – including beer.

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[266] The impact of US brands on the Canadian market at the time of the trade challenges is described by Scotia McLeod (1990 p. 18) as follows: "US beer labels have a significant place in the Canadian market.... The major labels of Anheuser [sic], Miller and Coors are licensed to Canadian brewers and, in present conditions at least, likely to remain so. These brands have approximately 15% share of the Canadian market."

[267] It should be noted that Canadian brewers – and market analysts - were not labouring under the perception that US brewers preferred these licensing arrangements to direct access. Woods Gordon (1987 p. 11) notes that: "We do not have the necessary information to judge the ability of American brewers to terminate their existing licensing agreements at a reasonable cost. According to the Canadian brewing industry representatives contacted, while some agreements will survive in the short-run, over the next twenty or so years, all of the agreements could be ended by the American licensors if it proved to be in their interest, since the agreements either have a definitive time limit or are open to buyouts. We have based the remainder of our long-run analysis on the assumption that if imports of American beer were not sufficiently hindered by regulatory or market forces, the existing licensing arrangements would be scrapped, and the leading American brands would be directly exported to Canada."

Chapter Five

The Trade Disputes Commence

Introduction:

This chapter begins the case study section of the dissertation which comprises the next four chapters. Each of the chapters of the case study is constructed in a similar fashion. First, a brief introduction is provided outlining the material to be covered. Next, the historical data is presented, interspersed with analytical commentary relevant to the theoretical component of this dissertation. The chapter concludes with an analysis of the explanatory capabilities of the initial, or statist, hypothesis set out in Chapter 3 against the case data.

To recall, the initial hypothesis asserted that the events encompassing the Canada-US beer dispute can be explained primarily by considering rational calculations about material interests at play in the two countries.

Since there are explanatory gaps between the evidence presented and the initial hypothesis, two alternative hypotheses are deployed to determine if they can help fill in what is missing. These two hypotheses are:

1. An epistemic community comprised of trade officials from Canada's Department of Foreign Affairs and International Trade and the United States Trade Representative's Office was in operation during the Canada-US beer disputes.

2. This epistemic community had a determinative impact on policy outcomes in the Canada-US beer disputes.

Chapter 5 covers as well the initiation of a series of international dispute settlement interventions by Canada's trading partners. These actions – which spanned the period 1979 to 1993 – focused on the dismantling of what many countries perceived to be Canada's protectionist practices for alcoholic beverages.

The trade incursions followed two tracks. The first, the European track, saw provincial liquor board practices governing wine and spirits as the primary focus with beer as a secondary concern. The field of engagement was the GATT.

The greatest impact of the European track was not in securing meaningful change for international alcohol suppliers selling in Canada. Rather, its most salient repercussion was its influence on the US government, which in turn determined to launch a second track of trade intervention targeting specifically the practices of Canadian provincial liquor boards on beer.

This second Canada-US track played out both bilaterally through the negotiations of the Canada-US Trade Agreement (CUSTA), which was negotiated and implemented in the latter part of the 1980s, and later on the multilateral stage through the GATT.

While this case study is concerned primarily with describing and analyzing the Canada-US GATT Panel process of Track 2, it is difficult to isolate those events from Track 1 as the issues were very similar and the Tracks operated neither independently nor sequentially, and in some instances overlapped. That is, some of the events on Track 1 occurred contemporaneously with and influenced developments on Track 2, and vice versa. For example, the US made submissions to the Panel reviewing the EC complaint, as did the EC on the Panel reviewing the US complaint. Chapter 5 thus focuses on the EC Track and on the nascent stages of the US Track.

The Pressure Mounts

As noted in Chapter 4, both European and US alcohol suppliers had for many years been coveting Canada as a potential market for their products. They had little success for two reasons. Both relate to provincial liquor board regulations.

First, all provinces had in place a number of severe barriers preventing most foreign producers from marketing their products to Canadian consumers. For example, the liquor boards operated harsh listing and delisting policies. These policies effectively kept foreign wine, spirits and beer in short supply in most provinces.

Second, even if foreign suppliers were successful in entering the Canadian market, other provincial measures constrained their ability to compete against Canadian producers. For example, provincial pricing and taxation policies generally left foreign products at a significant price disadvantage to Canadian-produced alcoholic beverages.

International alcohol suppliers had grumbled to their respective governments for many years about their treatment at the hands of Canada's provincial liquor boards. These complaints neither developed momentum nor discovered an avenue to affect change until the Tokyo Round of Multilateral Trade Negotiations (MTN).

Throughout the Tokyo Round, which spanned most of the decade of the 1970s, a number of parties – led by the European Community (EC), but also including the US, Australia, New Zealand and Finland – complained to Ottawa about the distribution and retailing practices of provincial liquor authorities.

Ottawa responded that the Canadian constitution prevented the government from directing the provinces to make changes to the practices of their respective liquor boards. However, recognizing the need to at least suggest a remedy in order to preserve Canada's reputation with its trading partners, Ottawa offered to function as a conduit to the provinces on behalf of the international trading community to help search for solutions. It was in this spirit that Canada's federal government committed to negotiate a set of measures with the provinces that each province in turn would agree to implement to bring its liquor board practices into compliance with international trade rules.

The role of Canada's federal government as 'conduit' between aggrieved trading partners and the provinces was a prominent feature of the beer disputes. Interestingly, while Ottawa advanced the constitutional impediment argument to its trading partners, both directly and in its submissions to the various GATT Panels, Canada's federal government was more direct with the provinces in domestic discussions. The importance of the distinction will be explored as the case study unfolds.

At this early point in the discussions, Canada's federal government took pains to act more or less simply as a go-between, shepherding demands and responses between foreign governments and the provinces.

The result of this activity was Canada's presentation in April 1979 to the EC of a series of provincial commitments on alcoholic beverages practices called the "Statement of Intentions (SOI)." [268] In the SOI, which Canada insisted was non-contractual in nature,[269] the provinces resolved to undertake the following steps:

- To make available on request information on the policies and practices of provincial marketing agencies for all alcoholic beverages to foreign suppliers and governments. Any enquiries from foreign governments were to receive a response within a reasonable period of time. The Government of Canada also agreed to be the channel of communication with foreign governments for such purposes.
- Provide a catalogue of all the products offered for sale by the agency in each branch store of the provincial marketing agencies so that customers could know what products were available in addition to those carried in the particular branch.
- Any differential in markup between domestic and imported distilled spirits would be calculated to reflect normal commercial considerations, including higher costs of handling and marketing, which were not included in the basic delivery price.

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[268] As it was part of the larger Tokyo Round negotiations, the SOI was provided on a MFN (Most Favoured Nation) basis to Canada's other trading partners as well.

[269] Rodney de C. Grey, Ambassador and Head of the Canadian MTN Delegation, wrote to P. Luyten, Head of the Delegation for the EEC, to make this point on 5 April 1979: "While the provincial statement regarding the treatment of imported alcoholic beverages is necessarily non-contractual in nature, it represents a positive undertaking to follow policies and practices which should be of considerable benefit to EC trade in this field in future years and, as such, is a valuable contribution to a settlement between us in this area." Canada made further representations on this issue to the EC Panel that the EC Panel Report (p. 4055) later summarized: "Canada argued that the description of the Provincial Statement of Intentions as 'non-contractual' was related to the constitutional inability of Canadian provinces to enter into formal treaty obligations with foreign powers and meant that the Statement was not intended to constitute a legally binding treaty in its own right."

- Any differential in markup between domestic and imported wines would not in future be increased beyond existing levels, except as might be justified by normal commercial considerations.
- Each provincial marketing agency for alcoholic beverages would entertain applications for listing of all foreign beverages on the basis of non-discrimination between foreign suppliers, and commercial criteria such as quality, price, dependability of supply, demonstrated or anticipated demand, and other such considerations as are common in the marketing of alcoholic beverages. Standards with respect to advertising, health and the safety of products were to be applied in the same manner to imported as to domestic products. Access to listings for imported distilled spirits would in the normal course be on a basis no less favourable than that provided for domestic products and would not discriminate between sources of imports.
- Any changes necessary to give affect to the above would be introduced as soon as practicable. However, some of these changes, particularly with respect to mark-up differentials, were to be introduced progressively over a period of no longer than eight years.[270]

What was remarkable about this document was how little the provinces committed to change. Consequently, most liquor boards saw no reason to amend their operations to comply with the SOI's terms. Their sense of comfort was reinforced by the eight-year transition period the document provided. Furthermore, there was no suggestion in the SOI of what the potential sanctions for non-compliance might be, nor was there a commitment by Canada to report on the progress of implementation. Therefore, for most provinces, the post-SOI world meant business as usual.

An additional notable feature of the SOI was that beer was not referenced specifically. This was primarily because foreign distillers and vintners had pressed the lobbying efforts that resulted in the framing of the SOI. Both Ottawa and the liquor boards thus felt that the focus of their reforms should be on addressing the concerns of foreign wine and spirits suppliers.

However, the EC protested the silence of the SOI on beer immediately after Canada presented the document to the EC Embassy. The EC Ambassador for Multilateral Trade Negotiations sent a letter raising the issue with Canada.[271]

His Canadian counterpart, Ambassador Rodney de C. Grey responded in a letter dated April 5, 1979, stating that:

> We can confirm that the term 'alcoholic beverages' includes ... distilled spirits, wines, vermouth, champagne and beer ....[272]

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[270] Provincial Statement of Intentions. (1979)

[271] The Luyten letter does not appear in the BAC archives, which was the most complete record of correspondence on the beer disputes available for the research of this dissertation. However, that de C. Grey responded via letter suggests that Luyten likely wrote him on the matter.

That beer came to be included in the SOI in such an off-handed way – i.e. by means of a side-letter between Canadian and EC negotiators – was likely the result of one of the following three scenarios. First, it may have been agreed by Canada and the provinces in their negotiation of the SOI that references to 'alcoholic beverages' included all the categories noted in de C. Grey's letter, and needed no further elucidation. Consequently, when the EC requested additional specificity, de C. Grey was able to provide it quickly knowing that the provinces had already agreed. Alternatively, it could have been a move by Ottawa to mask a commitment in such a way that both the provinces and the Canadian beer industry would be unlikely to notice.[273] Finally, it may have been a step taken by Ambassador de C. Grey simply to confirm informal discussions with his EC counterpart – and neither he nor his colleague felt it important enough to require that the SOI be redrafted.

Whatever the reason, that beer had now been referenced in an official communication between Canada and an aggrieved trading partner would have significant ramifications in the discussions that followed. Canada had committed to make changes on beer – and it would be expected by its trading partners to deliver.

At approximately the same time as Canada and the EC were discussing the SOI, activity began to stir in the US on many of the same issues. US brewers were beginning to make the rounds in Washington to register their concerns about the practices of provincial liquor boards on beer.

Some US brewers, through the United States Brewers Association (USBA), commenced exploratory lobbying with the Office of the United States Trade Representative (USTR) to express alarm about the relative success of Canadian beer imports in the US market as compared to US beer exports to Canada.[274] The US brewers' view was that provincial liquor board policies were preventing the growth of US beer in Canada[275] – and, at the same time, an 'open' US market[276] was being inundated with imports, many originating from north of the border.

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[272] Letter from Canadian MTN Ambassador Rodney de C. Grey to P. Luyten, EC MTN Ambassador. (5 April 1979).

[273] It is clear from their lack of response to the side-letter that neither Canada's brewers nor the provincial liquor boards regarded it as a matter of serious concern at this specific point in the process. It was likely their view that, if there were to be any changes forthcoming, it would be in the areas of wine and spirits.

[274] While it is unclear from the correspondence reviewed for this dissertation what brewers were pressing the issue, in light of future events, it was likely Stroh, Heileman and Anheuser-Busch.

[275] A letter from Allan R. Rubin of the United States Brewers Association (USBA) was sent to the members of the USBA on 21 July 1978 detailing discussions that were being held with the USTR on Canadian practices. The letter states that: "In both absolute and comparative terms, United States beer exports to Canada can be characterized as minimal. For a long time the United States industry has felt that Canadian tariff and non-tariff trade barriers are largely responsible for this unfortunate situation." The letter goes on to suggest that there were negotiations planned with Canada in the Fall of 1978 – though it is unclear whether they ever took place.

[276] 'Open' is placed in quotation marks because, as Beer II was to demonstrate, the US market was anything but 'open' to imports.

While there is evidence of an interest at the USBA about pursuing this argument with the USTR further, the initiative did not progress to the point that it was taken up aggressively by Washington with Ottawa. A significant reason was that the California Wine Institute was a much higher political priority for the US government at that time, and the USBA was aware of this.

The prominence of California's vintners was established in part by the strength of their shared view that something had to be done to force Canada's provincial liquor boards to treat Napa and Sonoma Valley wines fairly. The same level of solidarity did not exist in the US beer sector. As mentioned in Chapter 4, some US brewers had lucrative licensing agreements with Canadian partners that they did not want jeopardized by a trade intervention.

In addition, Ronald Reagan, a former California Governor who enjoyed a longstanding relationship with the California wine industry going back to his gubernatorial days, was making what would be a successful bid for the US presidency. California vintners felt that Reagan's tenure might be their best window of opportunity to press Canada to make changes to provincial regulations on wine.

The California Wine Institute went so far in this effort as to draft a Section 301 petition, which it decided subsequently not to file – likely because the EC moved on the issue first.

Although the California Wine Institute's petition was not filed formally, it did influence events. The vintners leaked the petition intending to intimidate the provinces with the prospect that a formal complaint might follow. Because of the leak, the document was widely circulated amongst and read by federal government officials in both Canada and the US, as well as provincial bureaucrats in Canada.

Meanwhile, the Brewers Association of Canada (BAC) discovered the USBA's efforts in Washington to step up pressure on the USTR, and became sufficiently troubled to seek commitments from the provinces to the *status quo*.[277] However, it was along Track 1 that the pressure for change was building most dramatically.

As noted above, that the EC and its domestic industries were unsatisfied with the terms of the SOI. They believed that the SOI was not very much – and, for the little that it was, they suspected that the provinces would ignore it anyway.

The EC Director General for Agriculture, CI Villath hammered this point home in a letter to Canada's Ambassador to the MTN, Rodney de C. Grey dated 29 June 1979.

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[277] The BAC prepared a series of briefing notes in 1978 titled: 'Notes for discussions with senior provincial officials regarding possible pressures emanating from Washington to allow access of US beers into Canadian markets.' They were used to brief provincial officials across the country about the need to maintain the *status quo* on liquor board practices.

In the letter, Ambassador Villath pointed out that there was 'disquiet'[278] amongst European vintners and distillers about the terms of the SOI. Moreover, he advised that there was also trepidation about the provinces being left to their own devices to implement the SOI. Consequently, he indicated that it was the EC's view that it was ultimately Ottawa's obligation to ensure that the SOI would be implemented.[279]

The EC became even further disconcerted on discovering that instead of moving to implement the terms of the SOI, provincial liquor boards had begun to put into operation new regulatory measures, many of which made matters even more disadvantageous for European alcohol products. For example, the EC learned that some provinces were raising the differential markups on European products to even higher levels with, in the EC's view, no commercial justification.[280]

Seeing no alternative, the EC requested that Canada enter into formal consultations on the practices of provincial liquor boards under Article XXIII:1 of the GATT in June 1984.[281]

The consultations with Canada were unsuccessful,[282] and as a result the EC requested a Panel on 12 February 1985 to examine the matter under Article XXIII:2 of the GATT.

GATT Dispute Settlement

Before discussing the EC Panel process and its outcomes, it is important to touch briefly on the nature of GATT dispute settlement mechanism generally. While GATT dispute settlement may appear on its surface to have been largely a legal process freighted with submissions, deliberations, findings and penalties, in reality it was only partially so.[283]

GATT dispute settlement is better characterized as a delicate pre-negotiation dance. Findings of GATT Panels were not intended to resolve disputes. Rather, they focused on setting the ground rules for negotiations between disputants that invariably followed Panel proceedings. Parties either accepted or rejected a Panel's findings. Given its largely voluntarist nature, there was little that the GATT could do to enforce Panel Reports.

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[278] Letter by CI Villath, EC Director General for Agriculture to Rodney de C. Grey, Canadian Ambassador to the MTN. (29 June 1979). The precise phrase is: "This examination has led to some disquiet about the terms of the statement of intentions…."

[279] Letter by CI Villath, EC Director General for Agriculture to Rodney de C. Grey, Canadian Ambassador to the MTN. (29 June 1979). Villath notes that: "I must in any case inform you that the Community will be looking for proof in the performance of the Provincial Liquor Boards that the undertaking is effective in eliminating discrimination against Community spirits. And, the Community does of course expect Canada's federal government to maintain its own surveillance of the way in which the undertaking is being implemented."

[280] EC Panel Report (p. 4056)

[281] For a listing of the specific articles of the GATT, see: General Agreement on Tariffs and Trade (1969).

[282] It is important to note that this outcome is not unusual in terms of GATT dispute settlement. Most consultations between disputants were unsuccessful.

[283] The past tense is used in discussing the GATT dispute settlement process as the World Trade Organization (WTO) dispute settlement process has since succeeded it. While there are many similarities between the two, there are also clear differences. For example, the WTO process is far more rigorous in enforcing Panel findings.

Ultimately, the only leverage available to the Contracting Parties and the GATT Secretariat for enforcing Panel decisions was the collective desire of most states to preserve order in the international trading system. The 'beggar thy neighbour' morass that could result from states ignoring GATT rulings was seen as detrimental to all nations; and, therefore, most states regarded it as an outcome to be avoided.

Consequently, while there were few sanctions available to force countries to adhere to Panel findings - except perhaps, authorization of retaliation, which occurred only once in the history of GATT[284] – they tended to do so all the same.

Despite the lack of rigour associated with GATT dispute settlement in general terms, the EC Panel against Canada did ultimately have an important impact on the course of the beer disputes. For example, the EC Panel process established the ground-rules for the period of negotiation between Canada and the EC that followed. Moreover, the Panel earmarked a series of issues requiring further deliberation that were later to be taken up by the US Panel. Lastly, because of the stakeholder consultations launched by Ottawa during the EC Panel process, the roles and responsibilities of the various Canadian participants, (including, federal and provincial elected officials and bureaucrats, the industry, interest groups and the unions), were clarified

Canada and the EC agreed before GATT Council on 12 March 1985 that a Panel would be required to assist in resolving the dispute.[285] The Panel first met on 18 December 1986. This was followed by a series of meetings in 1987 (on 25-26 March, 2 May, 7-8 July, 21-23 July, and 8-10, 14 October). The United States, New Zealand, Australia and Spain reserved the right to make submissions to the Panel, and Jamaica and Trinidad and Tobago asked to be consulted on the Panel's terms of reference and composition. Given their commercial interests, Australia – largely for its wine exports - and the United States presented to the Panel on 26 March 1987.

Ottawa's "Stakeholder Management"

During the EC panel process Ottawa asserted its authority to, first, direct any participation in dispute settlement proceedings relating to agreements to which Canada was a party, and second, to conduct negotiations on trade issues with foreign governments.

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[284] The Netherlands was authorized to suspend concessions against the US A in the 1950s over US dairy import restrictions. However, given the relative size of the Dutch and US economies, in the end the Netherlands decided not to retaliate.

[285] For the Panel to be convened, both Canada and the EC were required by GATT rules to accept it.

However, the Canadian federal government officials also recognized that there were constitutional and political realities preventing Ottawa from simply compelling the provinces to implement an agreement on matters that were generally acknowledged to be within provincial control.[286]

The Canadian federal government's view on these circumstances is summarized by a DFAIT trade official involved in both the EC dispute settlement process and the negotiations that followed:

> We knew we had to involve the provinces because it was their practices that were being disputed. Nevertheless, we also felt that we [Canada's federal government] had the broader mandate to handle international trade for Canada. Canada is the signatory to GATT and the FTA – not the provinces.[287]

To manage the various groups with an interest in provincial liquor board practices, DFAIT assembled a stakeholder team of provincial government representatives and others to provide advice and counsel directly to the federal negotiators. The group included, at various times, representatives from all ten provincial governments and officials from their respective liquor boards, Canadian industry delegates and unions representing Canada's brewery workers.[288] Thus began the peculiar dance between Ottawa and the alcohol sector stakeholders that continued for much of the decade ahead. Its cadence came to be very familiar to all those who participated.

The sessions usually exhibited the following pattern. While DFAIT officials were involved either in making representations to the Panel or negotiating directly with EC representatives or with the US in Ottawa, Geneva, Brussels or Washington, the stakeholder group waited in a meeting room at the Canadian embassy in the host city.[289]

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[286] A Canadian federal government official interviewed for this dissertation outlines Ottawa's perspective on the conditions affecting its mandate as follows (Dissertation interview): "In legal terms, Ottawa has ultimate control over international trade. However, in a political sense, there were limitations on our mandate. To account for this, DFAIT knew that negotiations had to be conducted with at least some visible evidence of the steps taken to create consensus. It was also clear, though, that Canada was not going to damage its international trade position for the sake of one industry." Trade representatives from other countries also recognized Ottawa's challenge. A US trade official interviewed for this dissertation noted that (Dissertation interview): "While Ottawa tried to exercise control, they were really hamstrung by the Canadian constitution."

[287] Dissertation interview.

[288] For the EC discussions, the industry group included representatives from Canada's national and regional wine and spirits associations, a grape growers group from Ontario, and a representative of the Brewers Association of Canada. But, not all groups were present at every session. There were two reasons for this. First, the expense of sending representatives to the various international locations where discussions occurred became daunting, particularly to some of the smaller provinces. Second, over the years the issues became refined to the point that only Ontario, Quebec, BC and the BAC – and, ultimately, only Ontario, Quebec and the BAC - felt a need to send representatives.

Before the morning negotiating session, the DFAIT team convened the stakeholder group to review submissions, discuss tactics and agree on a position to take forward. The DFAIT team returned occasionally at the lunch break, discussed the morning's events, gathered input from the assembled stakeholders, and then rejoined either the Panel submission process or direct negotiations. The day would end with Canada's federal negotiators briefing the stakeholder team on the events of the afternoon, and discussing what would have to be done to press toward an agreement in the next session. Because Canada was in the position of defending provincial practices, this usually involved identifying items that could be conceded by the provinces to help close the gap with either the EC or the US in order to secure an agreement.

It was in this area – the granting of concessions – that most of the disagreements between the stakeholder group and DFAIT officials arose. The specific circumstances surrounding these disagreements will be discussed over the course of this case study.

The stakeholder management process was imperative for DFAIT to handle its critics over the course of the alcohol beverage disputes. With the stakeholder group at the negotiating site and regularly consulted by the federal negotiating team, it was difficult for the provinces or other potential critics to claim that Ottawa did not solicit their views.[290]

DFAIT anticipated early on that there would be a significant risk to the political legitimacy of any deal without a solid record of consultation to which it could point. Ottawa could not risk that the provinces or the brewing industry and its workers could accuse it of 'selling out' without having at least talked to them.

The EC Panel

The EC complaint touched on a series of commercial issues related to provincial practices identified in consultations with its industry. The specific concerns on which the EC asked the Panel to rule were whether:

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[289] The Federal negotiators deviated from this pattern occasionally. For example, there were times when representatives from the various provinces were brought in to actual negotiating sessions to provide information about their particular systems. In addition, in the negotiations between Canada and the US, the industry was invited to explain to US representatives the operating procedures of industry-owned and operated entities like the Brewers Retail system in Ontario.

[290] Many of the Canadian stakeholders interviewed for this dissertation acknowledged DFAIT's commitment to consultation. However, a number also suggested that these consultations could be ingenuous. This view underlies stakeholder critiques of DFAIT's negotiating strategy. As one industry member interviewed for this dissertation noted (Dissertation interview): "The [Canadian] federal government's negotiating strategy was generally poor. They usually started the negotiating sessions by revealing their bottom line." Another noted that (Dissertation interview): "While the [Canadian] federal government did consult with the provinces and the industry on negotiating strategy, they did not do nearly enough of it."

1. The Canadian provincial liquor boards marked up prices of alcoholic beverages more on imported products than on domestic products contrary to Article II or III of the General Agreement;
2. Discriminatory listing/delisting procedures and the availability of points of sale were inconsistent with Article III, XI or XVII of the General Agreement;
3. Canada had not fully complied with its notification obligations under Article XVII:4 of the General Agreement;
4. Canada had failed to take 'such reasonable measures as may be available to it' to ensure observance of the General Agreement by the provinces contrary to Article XXIV:12 of the General Agreement; and
5. The benefits accruing to the European Communities had been *prima facie* nullified and impaired.[291]

Canada responded to each charge in its brief to the Panel. Its most important rejoinders in terms of potential impact on liquor board practices and future negotiations were on the issues of cost of service and markups, the Protocol of Provisional Application, and the obligations of a federal state to enforce international agreements on its subnational governments under GATT Article XXIV: 12.[292] Canada faced a challenge on cost of service and markups because all of the liquor boards used these measures to price foreign products at significantly higher levels than Canadian alcoholic beverages. Ottawa took the position that the higher markups and cost of service charges were justified in commercial terms and therefore consistent with Canada's international trade obligations.

DFAIT officials demonstrated this point to the Panel by first noting that Canadian domestic wineries were required to manage a number of responsibilities to bring their products to market that foreign producers received automatically on being listed for sale by a provincial liquor board. For example, while Canadian wineries were themselves responsible for transporting their products to the stores, liquor boards managed store delivery for imported goods. By charging a differential markup, the liquor boards were simply recovering the costs of providing these services.

Canada also argued that, consistent with practices common to private commercial enterprises, liquor boards charged what they believed the market could bear for all of their wines. Since the provincial liquor boards marketed imported spirits and wines as premium products, it was only normal that they should be priced at a higher level.[293]

The EC responded that any additional 'cost of service' charged to European alcohol products must be directly attributable to higher costs required to transport, distribute and retail beer, wine and spirits originating from the EC, as well as a 'reasonable margin or profit.'[294]

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[291] EC Panel report (p. 4044)

[292] GATT Article XXIV:12 states that (GATT 1969 p. 44): "Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory."

[293] EC Panel report (p. 4057)

The second argument Canada advanced to rebut the EC complaint was on a GATT procedural matter known as the 'Protocol of Provisional Application' – or the PPA. The PPA is a provision of GATT law that, for all practical purposes, absolves a country from bringing into compliance non-conforming measures that were already in place before it acceded to the GATT. As a result of the PPA, original Contracting Parties to the GATT had their non-conforming practices in place in 1947 – the year the GATT was created – essentially 'grandfathered.'

Canada argued that as the Importation of Intoxicating Liquors Act (IILA) came into being in 1928, it constituted existing legislation and therefore was protected by the PPA.[295] Moreover, any measures taken under the Act that were introduced prior to 1947 – i.e. creation of liquor boards, distribution and cost of service policies, environmental rules, etc. – must also be grandfathered and thus not subject to the GATT.

The EC disagreed with Canada's interpretation of the PPA in its submission to the Panel. The EC's view was that the PPA did not apply to the IILA or legislation created under its provisions by the provinces because these laws were not of a 'mandatory' character – an essential requirement in GATT jurisprudence to trigger the PPA.

The EC further maintained that while the provinces may have chosen to create liquor boards and the accompanying regulatory regimes necessary to manage importation and distribution of alcohol, they were not required by the IILA to do so in a specified manner. Accordingly, the PPA did not apply, and liquor board practices should therefore not be viewed as 'grandfathered' and outside of Canada's obligations to its GATT trading partners.

A review of the language of the IILA would seem to confirm the EC's view that the IILA's provisions did not place a mandatory obligation on the provinces to establish liquor boards or any other specific measure to regulate the importation and sale of beverage alcohol. The IILA simply delegated to the provinces the right to manage the importation and distribution of alcoholic beverages.[296] It was up to the provinces themselves to settle on how to exercise the authority.

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[294] EC Panel report (p. 4056)

[295] EC Panel report (p. 4060)

[296] The relevant section of the IILA (Canada Gazette 23 June 1993 Chapter 1 (3.1)) states that: "Notwithstanding any other Act or law, no person shall import, send, take or transport, or cause to be imported, sent, taken or transported, into any province from or out of any place within or outside Canada any intoxicating liquor, except such as has been purchased by or on behalf of, and that is consigned to Her Majesty or the executive government of, the province into which it is being imported, taken or transported, or any board, commission, officer or other governmental agency that, by the law of the province, is vested with the right of selling intoxicating liquor."

The Panel ultimately sided with the EC on the PPA, ruling that:

> ...[T]he Contracting Parties had decided in August 1949 that this paragraph only referred to legislation of a mandatory character and that this decision had been confirmed on many subsequent occasions, most recently in 1984. The Panel concluded that the Importation of Intoxicating Liquors Act did ... [not qualify]....[297]

While Canada was unsuccessful with the Panel on this point, the issue of whether or not Ottawa was obligated to compel provincial liquor boards to comply with Canada's GATT obligations remained unsettled. The principal reason related to an additional argument raised by Canada about how far the GATT required a federal state to go in enforcing its international trade obligations with its sub-national governments (in Canada's case, the provinces).

Ottawa took the position with the Panel that Canada's obligation to enforce international treaty commitments with the provinces was tightly restricted by the Canadian constitution, under which the provinces were invested with the authority to manage liquor board practices. This right was further amplified and refined by the IILA.

Additionally, Canada was required by Article XXIV:12 of the GATT to take 'reasonable measures' to compel the provinces to comply with the GATT.[298] Ottawa argued that the 'reasonable measures' test was met by its brokering of the Statement of Intentions (SOI) on behalf of the provinces.[299]

Canada reported to the Panel that it had been in constant contact with the provinces about their need to come into compliance immediately from the point the SOI was transmitted to the EC in 1979, and that these communications were continuing. Moreover, there had been numerous queries from Canada's trading partners to review provincial progress on implementing the SOI. In each case, Canada had used its "good offices" to help prepare – and convey - responses by the provinces.[300]

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[297] EC Panel report (pp. 4086-4087)

[298] Canada argued to the Panel that the framers of the GATT had clearly anticipated the special circumstances of federal states in this area by choosing to include Article XXIV:12 in the treaty. If the framers had expected unitary states and federal states to be treated the same, there would have been no reason to have XXIV:12 in the GATT. Moreover, while the Panel could clearly choose to adjudicate whether the provincial measures at issue violated Canada's obligations under the GATT, the central point to be weighed was what, if anything, Article XXIV:12 obligated Canada to do about it.

[299] EC Panel report (pp: 4050-4051)

[300] The use of 'good offices' in this context is very important. In diplomatic terms, offering 'good offices' suggests an intermediary or 'helpful fixer' role for a third party in a dispute between two foreign countries. For example, one could expect this language to be employed by the United States to describe its attempts to broker a peace settlement in the Middle East. That Ottawa used it here is likely indicative of its need to not put at risk a larger trade principal by putting on record with a Panel

Likewise, in Canada's view, the extensive amount of information provided by the provinces and submitted to the Panel concerning provincial adherence to the 1979 SOI demonstrated that the liquor boards were generally living up to its requirements. Canada acknowledged that while more change was necessary, all provinces would be fully compliant within the eight-year transition window to which the provinces had committed (by December 31, 1987).

Ottawa also took the position that, in becoming a Contracting Party to the GATT, Canada had not consented to allowing the GATT Council to interpret the constitutional obligations of the provinces and Canada's federal government within Canada. No Contracting Party could be expected to cede its sovereighty to the GATT to that extent.

Canada's view was that its own domestic authorities were competent to make determinations on issues related to compliance. While Canada's federal government welcomed advice from the Panel, Canada alone would determine what 'reasonable measures' it would take to ensure provincial compliance with the GATT. If differences arose between Canada and the provinces in this regard, the responsibility to adjudicate a resolution resided with Canada's Supreme Court – not with a GATT Panel.

What is more, if a dispute of this nature was referred to Canada's Supreme Court, Ottawa advised that Canadian jurisprudence was evolving in such a fashion as to enhance provincial autonomy on matters derogated to the provinces by Sec. 92 of Canada's constitution. Consequently, implementation of the SOI by provincial liquor boards was all that was required for Canada to be fully compliant with its GATT obligations.[301]

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that it was obligated to compel the provinces to take actions on matters within their specific constitutional jurisdiction.

[301] Canada's position – as well as a concise review of relevant Supreme Court decisions - is recounted in the following passage from the EC Panel report (p. 4071): "In Canada's view these were issues which could only be authoritatively resolved by the Supreme Court of Canada. Canada said that the constitutional jurisprudence in Canada had undergone a constant evolution since Confederation in 1867, and that it was conceivable that future decisions of the Supreme Court would have the effect of expanding federal powers in these fields. However, Canada recalled that the decided cases did not support the proposition that the federal government could exercise direct control over these matters. First, unlike almost all other federations, the treaty implementation powers of Canada's federal legislation were limited. The Labour Conventions case of 1937 held that the Canadian federal parliament could not intrude into areas of exclusive provincial jurisdiction on the ground that treaty obligations were involved. Second, the 'Trade and Commerce' power had been given an extremely restrictive interpretation by the boundary transactions, excluding any authority over the internal distribution of imported or local products. There were isolated decisions, which had allowed, by way of exception, very limited controls over subsequent distribution when such controls had been deemed indispensable to a regulatory scheme respecting import policies. In Canada's view these decisions could not, however, be seen as a basis for any form of comprehensive regulation of retailing policy, either generally or in connection with a particular economic sector. Canada noted that a series of more recent Supreme Court decisions seemed to reverse the trend towards an expansion of federal

Canada's federal government had taken a very important step in stating firmly to the Panel that the provinces were fully empowered by Canada's constitution and the IILA to regulate the importation, distribution and sale of alcoholic beverages within their borders. The provinces took from this that Ottawa was not contemplating launching a court challenge to force the implementation of any GATT decision on liquor board practices. That a challenge could be forthcoming had been a matter of concern to the provinces, particularly Ontario.[302] With this clarification now on the record, the provinces, to this point circumspect in pressing their interests on DFAIT for fear of forcing a reference by Ottawa to the Supreme Court, began to insist on greater participation in the trade management process.

Other Contracting Parties with federal systems of government that were monitoring the Panel process were circumspect in their representations to the Panel knowing that a decision on the issue of 'reasonable measures' could have a significant impact on them in the future.

For example, Australia, which had been one of the more emphatic opponents of Canada's liquor board policies, made a statement to the GATT Panel that was more sympathetic to Canada on 'reasonable measures' than the EC had been. The Panel summarized Australia's argument as follows:

> … Australia considered that the introduction of federal legislation which might have an overriding effect on the political balance of a federation, by impinging on the constitutional arrangements and the division of powers between the national and provincial governments, as not being 'reasonable measures.'[303]

It is interesting that the United States did not follow Australia's line of argument in its presentation to the Panel.[304] The US demanded instead that:

'Trade and Commerce' power and effectively to re-establish the traditional limitation of federal authority to trans-boundary transactions."

[302] A study was launched at this time in Ontario involving the Ministry of Industry, Trade and Technology, the Ministry of Consumer and Commercial Relations and the Office of the Attorney General to assess Ontario's constitutional vulnerability on alcoholic beverages. The confidential report referenced the same cases and issues as Canada's federal government. However, it was less definitive about provincial authority than the Canadian federal government's representation to the GATT Panel suggested. Once the federal arguments were made suggesting that Ottawa was not about to move in this area, Ontario and the other provinces had their concerns allayed. Still, their relief may have been misplaced. As one DFAIT source interviewed for this dissertation indicated (Dissertation interview): "At the end of the day, Ottawa could repeal the IILA if it wanted."

[303] EC Panel report (p. 4078)

[304] The EC Panel report (p. 4079) summarizes US concerns as follows: "The United States noted that there were three types of restrictive practices by various provincial liquor boards which it believed were in conflict with the GATT (1) charging higher price mark-ups on the sale of imported beverages than provincially produced beverages or, in the alternative, beverages produced elsewhere in Canada (2) allowing the sale of imported beverages through fewer retail outlets than domestically produced

> … Canada could, and had to, do more than merely try to persuade its provincial governments to comply with Canada's GATT obligations. The United States was not convinced that the federal government of Canada could not challenge the provincial practices in its courts. The United States considered that the determination of what measures by Canada were 'reasonable' to ensure the observance of GATT provisions by provincial governments was not a determination left solely to Canada to make. The United States urged the Panel to recommend that Canada ensure the removal of these GATT-inconsistent measures applied by the provincial liquor boards.[305]

On its face, this may seem to be an odd argument for the US to advance. By reading it into the record, Washington risked one of its trading partners advancing a similar challenge at the GATT against US state regulations in a future dispute. Interestingly enough, that exact situation did occur when Canada later requested its own GATT Panel to investigate US federal and state alcohol regulatory and taxation practices, alleging that they discriminated against Canadian beer and wine exports.

In responding to Canada's arguments before that later Panel – which was referred to as 'Beer II' by trade officials and the stakeholder group - the US took the exact opposite line on Article XXIV:12 as it did before both the EC Panel and Beer I (and, incidentally, Canada also took opposite tacks in its argument before the EC Panel and Beer I as well – demanding that Washington had a duty to impose US trade obligations on the states).[306]

This reveals an important insight about GATT dispute settlement. That is, while all signatories are considered equal Contracting Parties to the agreement and thus able to use any and all trade remedies that the Treaty makes available to them, not all countries are alike in their ability to respond to GATT judgments. Though GATT operates as a rules-based system, the rules do not supplant the supremacy of state

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beverages, and (3) 'listing' restrictions that restrict the number of brands of imported products that may be sold."

[305] EC Panel report (p. 4061)

[306] Sanford Remack, Assistant General Counsel at the Office of the USTR argued in his oral presentation to the Beer II panel on 1 October 1991 that Washington could not act to press the treaty obligations of the US in an area under state jurisdiction because: "…[S]tates are independent jurisdictions with substantial law-making authority because of the 10th Amendment, and where authority is particularly strong in areas of alcoholic beverages regulation because of the 21st Amendment." The Beer II Panel report is: U.S. – Measures affecting alcoholic and Malt beverages. *General Agreement on Tariffs and Trade. Basic Instruments and Selected Documents. Thirty-Ninth Supplement. Protocols, Decisions, Reports. 1991-92 and Forty-eighth Session.* Geneva: The Contracting Parties to the General Agreement on Tariffs and Trade. December 1993. Report adopted 19 June 1992.

power over events. So, while a country like Canada depends on effective management of trade rules to ensure that its interests are protected, and generally takes careful heed of GATT judgments, the US can pick and choose to a degree what it will accede to. That is why Washington could execute such a startling reversal before the GATT. Moreover, it could do so without significant concern that it would be linked to a future dispute. Ultimately, Washington does not have to do anything it does not want to do in the international trade system as it has the power 250 million US consumers – as well as other measures like military assistance and foreign aid - to hold over its trading partners.

The EC Panel Report:

The EC Panel distributed its report on 7 February 1988. The Panel Report weighed the arguments made by both Canada and the EC, as well as the submissions of the US and Australia, and stated the following conclusions:

- The Provincial Statement of Intentions and related letters could not be held to modify Canada's obligations arising from the inclusion of alcoholic beverages in its GATT schedule. Mark-ups which were higher on imported than on domestic alcoholic beverages could only be justified under Article II:4 of the General Agreement to the extent Canada discharged the burden of proof that additional costs were necessarily associated with marketing of the imported products;
- Certain practices concerning listing/delisting requirements and the availability of points of sale were restrictions made effective through state trading operations and were contrary to Article XI:1. Because such restrictions were not legislation of a mandatory character under the Importation of Intoxicating Liquors Act they were not grandfathered by paragraph 1(b) of the Protocol of Provisional Application of the General Agreement on Tariffs and Trade;
- Canada had complied with its obligations under Article XVII:4(a) but should supply some additional information so that this could be substantiated.
- Canada had not taken all reasonable measures to ensure that the provinces complied with the General Agreement because the efforts made by the Canadian federal government were directed to the Canadian interpretation rather than the interpretation the Panel had given the relevant provisions and thus did not comply with Article XXIV:12 of the General Agreement.[307]

In light of these findings, the Panel recommended that the Contracting Parties request Canada:

1. To take such reasonable measures as may be available to it to ensure observance of the provisions of Articles II and XI of the General Agreement by the provincial liquor boards in Canada;

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[307] EC Panel report (p. 4088)

2. To report to the Contracting Parties on the action taken before the end of 1988, to permit the Contracting Parties to decide on any further action that might be necessary.[308]

The Panel Report was devastating. Canada had lost on virtually all counts. It was clear that the Statement of Intentions was inadequate, that many liquor board practices – including, listings policies, differential markups for the purposes of collecting cost of service, etc. – must change, and that Ottawa was compelled to assure that the provinces come into compliance with Canada's GATT obligations, even if it was an area clearly within provincial jurisdiction.

The only bright lights for the provinces in the judgment were that Canada's characterization of liquor boards as state trading enterprises under Article XVII was upheld as was the ability of the provinces to raise revenue through the collection of mark-ups. Moreover, no serious questions were raised about the legal authority of liquor boards to operate as import and distribution monopolies for alcoholic beverages.[309]

With this Panel result as backdrop, officials at DFAIT were tasked with negotiating a settlement on alcoholic beverages with the EC. Their point of departure was a clear desire by Ottawa that an agreement must be reached to end the dispute. Moreover, it was considered unacceptable by Ottawa for the dispute to drag on past the report date called for in the Panel (31 December 1988).[310]

Despite this strong bias in favour of driving hard to achieve a settlement, there was also a sense amongst Canada's federal negotiators that it was necessary to defer at least somewhat to the authority of the provinces in formulating a defence for liquor board practices. Consequently, provincial representatives were present in Europe for many negotiating sessions to assist in the process. Moreover, the rest of the stakeholder group that had been assembled for the Panel hearings to consult with Canada's federal government negotiators – the wine and spirits industry, the grape growers and the brewing industry – would also continue to be involved.

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[308] EC Panel report (p. 4088)

[309] As the EC Panel report noted (p. 4087): "The Panel wished to stress that nothing in its conclusions on restrictions on points of sale and discriminatory listing requirements affected the right of Canada to use import monopolies for purposes foreseen in the General Agreement, such as the protection of the health of its population (Article XX), provided that it was done consistently with the relevant provisions of the General Agreement."

[310] Canada was concerned that other issues then in play – i.e. softwood lumber, B.C. salmon – might be swept up in the alcohol dispute if it was allowed to go on too long and bring in too many other Contracting Parties – particularly the US. Moreover, Canada had a history of working to settle its GATT disputes quickly. Many other Contracting Parties allowed disputes to languish for years – often never reaching definitive settlements. This was a significant reason underlying the initiative later taken at the WTO to firm up dispute settlement procedures. Canada's interest in working to resolve disputes quickly is rooted in the fact that it is a small country that is heavily dependent on trade to sustain economic growth. It needs a smoothly functioning international trading system in order to allow its goods to be sold abroad. Other parties – i.e. the US or the E.C. – are much better able to withstand protracted disputes and the threat of retaliation if they are not settled.

The EC Panel Negotiations:

Canada and the EC spent the better part of a year in what were often acrimonious discussions to settle the dispute on provincial liquor board practices. However, most of the acrimony was not between the EC and Canada. Often it involved Ottawa and one or more of the provinces. For example, at one point, following a decision by DFAIT officials to accede to EC demands to remove markup preferences in Ontario for 'Ontario brandy', the Ontario government delegation staged a walkout in open session with the EC. This was not to be the last dispute between Ontario and Canada's federal government over Ontario's liquor board policies.

Despite continuing rancor in the Canadian camp, Canada and the EC reported to the Contracting Parties in December 1988 that a settlement had been reached. The proposed agreement was far ranging and covered a number of practices in the beverage alcohol sector.[311]

While the draft settlement was directed principally at provincial liquor board practices on wine and spirits, which was consistent with DFAIT's views on the items for focus in the negotiations, the proposed settlement also mentioned regulations governing beer.

The draft agreement's references to beer were in the main consistent with the results negotiated for wine and spirits. For example, it called for 'national treatment'[312] to be accorded EC products generally, and specified a number of further reforms to make provincial regulatory regimes that would be "... non-discriminatory, transparent and not create disguised barriers to trade...."[313]

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[311] The BAC (1997 pp. 82-83) describes the agreement in the following terms:

- On distilled spirits, national treatment in respect of measures affecting listings, delistings, distribution and mark-ups;
- On wine, national treatment in respect of measures affecting listings, delistings and distribution; on mark-ups Canada agreed, generally, to eliminate 20% differentials by April 1, 1989; and 20% each year from 1990 and 1993 (the provinces of BC, Ontario and NS were accorded different schedules);
- On beer, national treatment in respect of measures affecting listings and delistings, on mark-ups Canada agreed not to increase any mark-up differential that existed as of December 1, 1988.

[312] The term 'National Treatment' is defined in GATT by Article III. For the purposes of the beer disputes, Article III(4) became the operative reference. It stated that (GATT 1969 p. 6): "... The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product."

[313] Canada – Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies. *General Agreement on Tariffs and Trade. Basic Instruments and Selected Documents. Thirty-ninth Supplement. Protocols, Decisions, reports 1991-92 and Forty-eighth Session.* Geneva: The Contracting Parties to the General Agreement on Tariffs and Trade. December 1993. Report

However, the steps that the proposed agreement outlined for beer were not contemplated by the Panel report. Consistent with a broader vision that Ottawa held for beverage alcohol regulatory reform across Canada, the proposed settlement committed Canada to further reform measures for beer. Specifically, it stated that:

> … Canada undertook to bring measures on pricing of beer into conformity with its GATT obligations, this undertaking is contingent on and would follow the successful conclusion of federal-provincial negotiations concerning the reduction or elimination of interprovincial barriers to trade in alcoholic beverages, including beer.[314]

The linkage of the GATT disputes to a larger Canadian federal government agenda, which focussed on removing IPBs, would be a key driver of events throughout the course of both the EC and US phases of the beer disputes. This theme will be explored in further detail as the story of the beer dispute unfolds.

Canada's brewers had to this point been interested, though largely passive participants in negotiations on the EC Panel.[315] Although the President of the Brewers Association of Canada (BAC) attended several of the stakeholder sessions in Europe and Canada, there was little reason to believe that the EC was focused on beer.[316]

While there was some trepidation amongst Canada's brewers at being included in the proposed EC settlement at all, that it raised a future agreement on interprovincial trade barriers (IPBs) as the trigger for change mitigated this concern substantially. This was chiefly because Ottawa had proven repeatedly that it was incapable of shaking the dogged devotion of most provincial governments to protecting their own industries from out-of-province competitors. If past behaviour is the best indicator of future events, the brewers felt they had little reason to worry about the proposed EC settlement.

However, had Canada's brewers linked events occurring on Track 1 of the beer disputes with developments on Track 2, they might have been less sanguine about the proposed EC Panel settlement.

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adopted by the Panel on 18 February 1992. (p. 12). This GATT Panel report will be referred to hereafter as the Beer 1 Panel Report.

[314] Beer 1 Panel report (p. 12)

[315] Trade consultants to the BAC who clearly recognized – and had confirmed by later events – the prospects for significant billings should the beer sector be included in the GATT Panel discussions, did their best to stoke the interest of the Canadian brewers in the EC process.

[316] The volumes exported by EC brewers to Canada at this time were small. Moreover, like their US counterparts, any EC brewer – for example, Carlsberg – interested in the Canadian market entered a licensing agreement with a Canadian brewery.

Tracks 1 and 2 Converge

To recall, there were two tracks operating in the beer disputes – one involving the EC – Track 1, and the other the US – Track 2. With the proposed EC settlement, the two tracks began to converge – particularly in the minds of officials at DFAIT.

These external pressures represented an interesting opportunity for Ottawa to force changes on the provinces that had previously been defeated by the realities of Canadian politics. Canada's federal government was no longer the demandeur – it was now Canada's trading partners. This created new leverage for Ottawa in its effort to dismantle IPBs.[317]

Girding DFAIT's rationale for insisting on beer being downplayed by the draft agreement with the EC was that discussions on a Canada-US Trade Agreement (CUSTA) had revealed an active interest in the US to dismantle Canada's practices in the beer sector.[318] As the US was expected to retain its GATT rights should the CUSTA reach fruition, DFAIT officials anticipated a trade challenge on beer imminently.

Moreover, DFAIT officials resolved that a Panel report hardly mentioning beer, brought by a complainant with little legitimate commercial interest in the Canadian market[319] was, in a political sense, not the vehicle to force dramatic restructuring on an iconic Canadian industry with a proven ability to influence the political process.[320] A better course of action was to wait for the US to play its next card.

Reporters for Canada's Globe and Mail newspaper also cited political sensitivity by Ottawa as the rationale for beer being largely excluded from the EC settlement.[321] However, the political concern referenced by the Globe and Mail relates more to speculation by the reporters, no doubt fuelled by DFAIT sources with an interest in deflecting potential criticism, that DFAIT had to be concerned about the potentially devastating impact on Canada's brewers – particularly in the smaller provinces - of cheap US beer flooding the Canadian market.

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[317] A senior DFAIT official interviewed for this dissertation noted that (Dissertation interview): "We knew that dealing with the IPB file would just be a matter of time – particularly for beer, which was one of the biggest sticking points in the negotiations. Once CUSTA, the EC dispute and the US dispute all came together, there was no way that the provinces could resist the need to change the practices of their liquor boards. After a long while of frustration, we started to get lucky as the 80s drew to a close and the 90s began."

[318] A USTR official interviewed for this dissertation noted: "We kept beer out of the FTA because we knew that the EC had already put provincial practices in play at the GATT. This allowed us to justify to our stakeholders Canada keeping beer out of the FTA. We all knew that beer would be dealt with in the GATT."

[319] As one news report at the time noted (Ed Greenspon and Christopher Waddell, the Globe and Mail. 26 January 1989): "All along, Canadian officials have told their European counterparts that beer is really only a piddling part of the issue because only $10 million a year of it is exported to Canada."

[320] As a DFAIT official indicated in an interview for this dissertation (Dissertation interview): "Canada's brewers had an enormous influence on both the provincial and federal levels of government."

[321] Ed Greenspon and Christopher Waddell (Globe and Mail. 26 January 1989).

The article states that:

> In the negotiations with the Europeans, Canada had been anxious not to concede on beer because of fears it would make it easier for US breweries to push for unfettered access to Canadian markets. Beer was specifically excluded from the terms of the Canadian-US FTA, in part because of the heavy pressure from Saskatchewan and Newfoundland. Those provinces were worried that many breweries would be closed, with workers in the highly-paid industry laid off in smaller provinces, if rules were eliminated that forced brewers selling beer in each province to produce it within that province.[322]

DFAIT officials were less troubled about the fundamental restructuring of the Canadian industry than the article suggests. In fact, not only were they largely unconcerned, DFAIT officials were hoping to bring it about.[323]

DFAIT trade staff were instead far more anxious about the political impact a settlement with the EC could have if it were to be interpreted by critics as Canada 'caving in' in international negotiations. This outcome could have jeopardized Ottawa's broader plan to leverage challenges on the international trade front to dismantle IPBs.

DFAIT officials understood – and presumably their EC counterparts did as well – that with the US lurking in the shadows there was no need to take a risk on the EC settlement to get at provincial trade barriers in the beer sector. These trade impediments would be dealt with eventually, at far less political risk.

In addition, DFAIT officials also recognized that the licensing deals that the larger US brewers had secured with Molson and Labatt would not permit the Canadian market to be penetrated by anything other than the smaller, US discount players in the near to medium term. While the discount players could have an important enough impact on the profitability of Canada's major brewers over the short term, their activities would likely not devastate the industry.[324] Molson, Labatt and regional players like Moosehead were big enough to compete with smaller US discounters, and provincial liquor boards had enough legitimate trade tools at their disposal to assist them.[325]

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[322] Ed Greenspon and Christopher Waddell (Globe and Mail. 26 January 1989).

[323] In a curious response to the question, "Do you think Canadian policymakers regarded the US Section 301 complaint as a useful development that could be leveraged to drive the dismantling of IPBs in Canada? Did Canada's negotiators encourage the USTR to press the case?" a DFAIT official interviewed for this dissertation answered (Dissertation interview): "Absolutely not. Canada never welcomed the US Section 301." While Canada may have not 'welcomed' the US action in this official's mind, he goes on to suggest why the Section 301 might not have been as unwelcome as his initial response insinuated (Dissertation interview): "There was recognition in the federal government that IPBs were impeding the [Canadian brewing] industry to compete. It was in the best interest of Canada to remove these barriers. Nevertheless, there were political interests to consider as well. Once the Section 301 emerged an opportunity was presented to point out the IPB issue which could then serve the broader federal agenda."

That Ottawa believed change to be on the way for Canada's brewing industry – and that this reform could be linked to progress on IPBs - is further confirmed by a publication released by the Federal Department of Industry, Science and Technology (ISTC) at approximately the same time as both the EC Panel process and implementation of the CUSTA.

In its 1988 profile of Canada's brewing industry, ISTC states that:

> International interest for improved access to Canadian markets will continue. With the adoption of the GATT Panel report, our trading partners are looking to Canada to implement changes to provincial listing, pricing and distribution practices relating to alcoholic beverages. The Canadian government has indicated that it is not prepared to implement changes to beer marketing practices in the foreseeable future. However, the Committee of Ministers on Internal Trade is currently working towards an agreement on the removal of the interprovincial trade barriers.[326]

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[324] For example, the experience of US discounts in BC and Alberta demonstrated that while the profitability of the industry would undoubtedly be affected, Canada's brewers could ultimately compete successfully.

[325] In response to the question "Did you believe the BAC's claims that the Canadian beer industry would cease to exist as we knew it with the implementation of free trade with the US in the beer sector,"a DFAIT official interviewed for this dissertation answered tersely (Dissertation interview): "No."

[326] ISTC (1988 p. 5). It is interesting to contrast this position with a Canadian federal government assessment of the brewing industry developed by the Department of Regional Industrial Expansion (DRIE) (Consumer Product Industries Branch 1984 p. 5) written just four years before, at the end of a Liberal government reign. While it may appear absurd given the trade challenges that followed, and further from today's prevailing perspective that government is 'not in the business of business', Ottawa was proposing to 'partner' with brewers to aid the industry's diversification and growth. DRIE's view of how best to manage the brewing sector was as follows: "Considering the financial health of the primary industry members, their strategic positioning to take advantage of market opportunities, and their role as good corporate citizens in Canada, the time may be opportune for government to assist the industry in its future development. By influencing both the direction and speed of its diversification into areas that offer the greatest long term growth potential, some or all of these firms could be the nucleus of a food and beverage sector that is of international calibre.' To accomplish this, DRIE set out the following recommendations (DRIE 1984 p. 28):

1. DRIE initiate discussions with the three major firms with a view to ultimately negotiating Memoranda of Understanding that could provide the guidelines for a working relationship

There were other events occurring at approximately the same time along Track 2 adding further impetus to the momentum building against provincial liquor board practices.

The Origins of the US Dispute

Though the Office of the United States Trade Representative (USTR) intervened in the EC Panel process to argue for change in provincial practices governing the beer sector, Washington was initially more focussed on attempting to reach a resolution on beer via the bilateral route.[327] The first serious bilateral effort by Washington on beer, following the earlier USBA-led lobbying on Canadian practices with the USTR, was embedded in wider discussions on the Canada-US trade relationship.

With the sweep to power of the Mulroney Tories in September 1984, the cautious dance between Ottawa and Washington executed by the Trudeau Liberals for most of the previous two decades[328] was supplanted by a rush by Canada's new federal government to pull the US into the closest embrace ever between the two countries.[329] The trade bond between Canada and the United States would be the

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designed to achieve the longer term economic goals of the companies in addition to certain government objectives;

2. DRIE participate in discussions at the federal level on the question of government taxation of the alcoholic beverage sector as a whole through full membership on the Special Task Force on Excise Tax; and
3. DRIE examine the possible implications of 'free trade' for the alcoholic beverage sector with a view to developing a departmental position that reflects industry concerns.

Given that DRIE was nowhere in evidence during the next decade of trade discussions, it is unlikely that the agency's beer agenda was advanced beyond this particular publication.

[327] The US industry was adding pressure to this drive for change. For example, the US Beer Institute (the successor organization to the United States Brewers Association) passed a resolution on 'Free Trade' in January of 1988 stating that (BAC internal memo. 10 January 1988): "Now, therefore, be it resolved by Beer Institute: That the President and Congress of the United States are urged to seek fairness in trade among nations through the elimination of barriers to the importation and sale of American beer in foreign markets." The first item of business in pressing this agenda was to work for change in Canada. However, the role of some members of the US Beer Institute in this process was a complex one. Given that the top three US brewers – that is, Anheuser-Busch, Miller (which became a part owner of Molson during this period) and Coors – all had lucrative licensing deals in Canada, they tended to sit on the sidelines. However, on occasion, Anheuser-Busch lobbied for the USTR to act against Canada. The mid-level US brewers – principally Heileman and Stroh – played a more straightforward role. They lobbied the USTR and key Members of Congress for action to be taken against Canada throughout the trade disputes.

[328] An invaluable treatment of Trudeau's relationship with the US is Granatstein and Bothwell (1990). See particularly: Part Two (pp. 39-107), entitled "Errand in the Wilderness: Canada and the United States."

[329] The historical record is clear that Canada was the demandeur in the CUSTA talks. For example, see: Hart (1994); Doern and Tomlin (1991) and Ritchie (1997). Canada's principal motivation was to avoid being swept up in the 'America first' view on trade policy that was becoming popular in Congress at the time. However, Marci McDonald (1995), who has little that is very positive to say about either the CUSTA or Mulroney, suggests that the exercise was more a conspiratorial effort by Washington to woo Canada into its vision of a North American economy. She offers little in the way

bedrock upon which this new relationship was to be erected. This first became apparent during the 'Shamrock Summit'[330] in March 1985 in Quebec City when President Ronald Reagan met newly minted Progressive Conservative Prime Minister Brian Mulroney. Michael Hart describes this meeting in his examination of the CUSTA negotiation process:

> In March 1985 ... the Prime Minister met with the president in Quebec City. Amid all the hoopla attendant on such major milestones in public diplomacy, the two leaders conducted some very serious business. At a meeting at the Chateau Frontenac on 17 March, attended by their closest foreign and economic policy advisors ... the two leaders put the finishing touches on a declaration on trade in goods and services. Both governments indicated that they wanted to examine seriously the broadest possible means for liberalizing trade between the two countries. They set in train a process for joint preparation so that should negotiations eventually be joined, they could produce results quickly. This document, in effect, set the agenda for the negotiation of a free-trade agreement.[331]

Coincidentally, there was also activity on the US brewing industry front that raised the profile of provincial liquor board practices in these very early discussions on free trade. The USTR, Bill Brock, (who would soon be appointed to Labour Secretary) attended the Shamrock Summit. He had clearly been briefed by his officials that there was discontent in the US brewing industry with Canada's provincial liquor board practices. He used the occasion of the Summit to register concern both officially and publicly.[332]

The Stroh Brewing Company of Detroit, Michigan and Heileman Brewing Company of Lacrosse, Wisconsin had taken their case to the USTR on the need to press Canada on beer.[333] On 3 April 1985, Stroh officials met with staff at USTR to

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of rigorous evidence for this position. However, it is a popular point of view shared by many 'anti-globalization' activists, and merits mentioning. This perspective is consistent with what Michael Hawes (1984) calls the 'Satellite' theoretical impulse in Canadian foreign policy writing.

[330] So-called because of the shared Irish heritage of the Prime Minister and the President.

[331] Hart (1994 pp. 68-69)

[332] A trade consultant for the BAC relayed a memo to the association (BAC internal memo. 19 March 1985) stating that: "Last week Representative Toby Roth [a congressman from Wisconsin – Heileman's home state] spoke to STR Brock [Bill Brock, USTR] about Heileman's desire to increase exports to Canada. Mr. Brock undertook to raise the issue with Mr. Kelleher [Canada's Trade Minister] in Quebec City. I sent briefing papers to Mr. Kelleher's policy advisor on Friday after advising him of Brock's intention. Brock mentioned beer trade three times during his interview on Canada AM [a news magazine program on the Canadian Television Network] this morning."

[333] It was rumored that Miller Brewing Company was supportive of the effort. However, the brewer was not willing to pursue it publicly or with USTR.

ascertain how a Section 301 complaint against provincial liquor board practices might be received. Section 301 is an infamous instrument – at least amongst countries relying on trade with the United States - contained in the 1974 US Trade Act. It mandates the US government to withdraw concessions from trading partners resistant to opening up their markets to US exports.[334] Despite offering a lukewarm response to the entreaties of Heileman and Stroh, USTR officials were informed by both brewers that a Section 301 petition was being prepared by their legal counsel and would be presented for official consideration within a month. The focus of the petition was to be on regulatory practices in the provinces of Ontario and Quebec.[335]

On learning of this development, Canada's brewers dispatched a number of consultants to meet in Washington with staff members of elected representatives from US 'beer states' as well as with officials at USTR.[336] The consultants learned that the lobbying efforts of Stroh and Heileman with elected officials had moved beer up the USTR's list of priorities.[337] The BAC's consultants further warned that, given what was becoming an increasingly fluid and tense situation[338] between Canada and the US on the trade agenda generally, there was a good chance that action on beer could be imminent.[339] This proved to be a prescient analysis as Stroh presented a draft Section 301 Petition to the USTR in August 1985. Both Heileman and the Christian Schmidt Brewing Company supported the Stroh petition.[340] The complaint covered the following issues:

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[334] For a review of the process and procedures related to Section 301, see the US Federal Register, (Vol. 55 No. 97, Friday May 18, 1990). Hart notes (1994: pp. 44-45) that the US administration was becoming particularly aggressive on Section 301 at the time to downplay the view in Congress that Washington had become a 'patsy' on trade policy: "To meet the surging protectionist tide, the administration went on the offensive on trade issues in 1985. It initiated investigations under Section 301 of the 1974 Trade Act, at first timidly, but as the protectionist surge failed to dissipate, more and more stridently."

[335] BAC internal memo (9 April 1985)

[336] Key beer states for the dispute were Wisconsin, the home state for Heileman, and Michigan, headquarters for Stroh.

[337] Staff for legislators that had been approached were musing about pursuing either a "Beer Equity Act" with Canada or drafting a "Sense of the Senate Resolution" urging the President to take steps to improve access to Canadian markets for beer (BAC internal memo. 1 April 1985).

[338] The reference to 'fluidity' in this context relates to the support for protectionism that was growing in Congress. As Hart (1994 p. 42) notes in a discussion of US trade policy: "Within Congress, trade policy came to be viewed as an important ingredient in formulating domestic economic policy and in meeting the needs of individual interest groups. Congress became increasingly oriented towards a 'fair-trade' ideology. It preferred to strengthen legal processes in pursuit of US trade interests." Canada's brewers saw provincial regulatory regimes as being put at risk by this rising tide.

[339] BAC internal memo (9 April 1985). In addition, the BAC began to lobby various provincial governments to ensure that they remained solid on their regulatory practices. For example, the BAC wrote the Chairman of the Alberta Liquor Control Board (ALCB) on 20 August 1985 (Letter from BAC to Mr. W. Skoreyko, Chairman of the Liquor Control Board of Alberta, 20 August 1985) to suggest the following: "Two US brewers, Stroh and Heileman, have been lobbying their federal government to improve their access to Canadian markets. It has been brought to our attention that at least one of them will file a formal complaint under Section 301 of the US Trade Act." The letter goes on to request that the ALCB provide some pricing information to the BAC to aid in the development of a Canadian defence.

[340] BAC internal memo (23 August 1985).

- Canadian restrictions including federal import duties on beer and containers that it claimed greatly exceeded the duties imposed on Canadian beer by the US;
- Arbitrary and exclusionary provincial 'listing' requirements'
- Exorbitant markups by provincial alcoholic beverage sales outlets in all Canadian provinces;
- The complete exclusion of US beer from retail outlets accounting for 95% of beer sales in Ontario, and a similar exclusion in Quebec of US beer from grocery and convenience stores.[341]

In making these arguments, Stroh sought the following remedies:

- Elimination of provincial listing requirements, except to the very limited extent that they genuinely related to standards of quality and safety.
- Acceptance by provincial liquor authorities of all US beers that met provincial health and safety standards;
- Provincial markups on US beers that are comparable to those imposed on each province's own beers in the principal outlets where they are sold;
- Non-discriminatory distribution and sales practices that would permit US beer to be sold in the same retail outlets as Canadian beer and that would eliminate the 'two-tiered' arrangements now prevailing in Ontario, Quebec and elsewhere;
- Import duties on US beer in Canada more closely equal to duties imposed by the US on Canadian beer.[342]

Just as the Stroh petition began to develop momentum within USTR, two important events overwhelmed the process. The first was the EC Panel – the second the CUSTA negotiations. Consequently, the energies of USTR were redirected – though, in both instances, beer clearly remained on the agenda.[343] Stroh accepted that its complaint would necessarily be on the backburner until these other processes were completed.

CUSTA

On Track 2, the most important event for the beer sector was the negotiation of the CUSTA deal. Given the various signals that had been sent to Ottawa over the years by both the US brewers and the USTR, most recently via Stroh's draft 301 complaint, it was clear that provincial liquor board policies would be raised in any discussions on free trade.[344]

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[341] BAC internal memo (23 August 1985).

[342] BAC internal memo. (23 August 1985).

[343] A memo from Washington trade consultants to the BAC (BAC internal memo 24 October 1985) stated that: "…[USTR staff]... will be meeting with Stroh today to discuss their draft Section 301 complaint. I do not have the impression that USTR is attaching high priority to this matter, but they do owe Stroh a meeting."

[344] For example, in response to US Federal Register notice 220, (Tuesday November 13, 1984), regarding the possible establishment of free trade with Canada, Heileman filed a statement with the Trade Policy Staff Committee on Free Trade with Canada which took a strong position advocating

A detailed examination of the CUSTA process related to beer would be a fascinating endeavor – and, given the paucity of published material on the subject, very worthwhile. However, it is something that is beyond the scope of this project. It is important, though, to appreciate the results of the CUSTA in the area of alcohol regulation as they had a significant impact on what followed.

Canada's brewing industry was troubled about the prospects of free trade between Canada and the United States in the sector of alcoholic beverages long before the CUSTA discussions were launched. As noted above, there were many suggestions earlier on that if negotiations were to be joined between Canada and the United States to develop some type of free trade area, the practices of provincial liquor boards would be introduced as an agenda item by Washington.[345]

Thus forewarned, Canada's brewers interceded in the CUSTA negotiations early and often. These interventions were guided by the view that there were few officials on Canada's CUSTA negotiating team with either sympathy for or understanding of the restructuring issues that the industry would face if US beer was permitted immediate, unfettered access to the Canadian market.[346]

Canada's brewers resolved that if the case for excluding beer was to be made to Ottawa – but also, to the provinces and the public - they would have to make it on their own. To help safeguard their views from being dismissed as ingenuous fear mongering, the BAC hired business consultants Woods Gordon to assess the impact of immediate open access for US brewers to the Canadian marketplace.

The findings of the Woods Gordon review were dramatic indeed. The report predicted that after roughly twenty years from the full implementation of a CUSTA, US discounted beers would gain approximately 32% share of the beer market in Canada, which would result in a direct and indirect loss of over 19,000 Canadian brewing industry jobs, of which 16,600 would be high-paying manufacturing jobs.

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free trade in beer with Canada. In its conclusion, Heileman recommends that: "The ultimate objective to be accomplished should be complete free, fair and open malt beverage trade between Canada and the US, with Canada being as receptive and open to US products as the US is to Canadian beer, and vice versa. Competition should be based on quality and price, not on protectionism of either country's product. Accordingly, G. Heileman Brewing Company vigorously supports the establishment of free trade, as to malt beverages … between Canada and the United States."

[345] Hart (1994 p. 194) notes that very early on in discussions on the negotiating agenda for the FTA, the US indicated that it would be very interested in obtaining concessions from Canada on beer and wine.

[346] That Canada's brewers were right to be concerned is validated by reports of many points in the negotiations where the US would have been pushing on an open door with Canada to insist that provincial alcohol regulatory regimes be dismantled. For example, Hart notes (1994 p. 233) that Canada's Chief Negotiator, Simon Reisman, entertained trading concessions on beer and wine to get a deal in some other important areas: "[Reisman] was prepared to push the Americans very hard on their meat import restrictions, their sugar quotas, their grading and sanitary regulations, and other barriers. In return, he was prepared to phase out the tariff on fresh fruits and vegetables, adjust import quotas, and deal with the vexing problems of beer and wine."

The report further estimated that this would translate into a loss of almost $190 million in wages, salaries and benefits, and over $180 million in raw materials purchases paid annually by Canada's brewers.[347]

Moreover, the impact would not just be on the Canadian brewing industry and its workers. The Woods Gordon report estimated a direct and indirect loss in federal and provincial commodity, corporate and personal income tax revenue of over $270 million annually as well as nearly $1.1 billion reduction in the GNP contribution made by the production and sale of beer in Canada.[348]

To conclude its study, Woods Gordon painted a bleaker picture still:

> With a more aggressive strategy of price-cutting and heavy promotion by American brewers, the risks to the domestic industry could even be more serious. It is quite possible that as much as 40% of the Canadian market could be captured by US breweries in this scenario, resulting in additional plant closures and thousands of further job losses.[349]

Armed with these bleak data, Canada's brewing industry leapt headlong into the CUSTA negotiations process. The BAC (Brewers Association of Canada) and its members appeared in many public fora to denounce unfettered entry of cheap US beer into Canada,[350] lobbied politicians at both the Canadian federal and provincial levels, including the Prime Minister,[351] as well as US officials in Washington, appeared in the media to denounce US proposals, worked with unionized brewery workers to arrange marches on provincial capitals, and, lastly, created a series of print ads (subsequently leaked to Conservative politicians, though they never actually appeared publicly) stating the industry's case in arresting terms.

Consequently, Canadian trade negotiators argued successfully, though reluctantly,[352] with their US counterparts that in exchange for accepting practices protecting the United States sugar industry,[353] the CUSTA would be largely silent on beer.[354]

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[347] Their assumptions for US entry are described on pp. 9-10 of the Woods Gordon (1987) document.

[348] Woods Gordon (1987 p. 27).

[349] Wood Gordon (1987 pp. 27-28).

[350] Hart (1994 p. 82) noted that in the public hearings on the FTA: "Spokespeople for the brewing and textile industries warned of the negative consequences of more open trading conditions for their industries." In addition, the BAC's files on the FTA are replete with news accounts of the brewer's views as well as briefing and speaking notes for various representations on the trade agreement.

[351] Doern and Tomlin (1991 p. 115).

[352] That Canada's federal government negotiators were reluctant in their efforts to help Canada's brewing sector is clearly evidenced by Canadian Deputy Chief Negotiator Gordon Ritchie's appraisal of what occurred (Ritchie 1997 p. 114): "... [W]e were unfortunately successful in protecting the antiquated provincial regulations governing beer. Every province wants its own brewery. As the head of BC's public-sector union said to his neighbour, Pat Carney [Federal Minister for International Trade], where else than at a brewery can a high school dropout make $30,000 a year? This does not strike me as a very good argument. It did impress the beer barons, who had bent to provincial

Doern and Tomlin's analysis of the CUSTA negotiations credits Canada's brewers with playing a deft game of brinkmanship which resulted in Ottawa acceding to the BAC's demands:

> The pressure for Canada to grandfather beer-industry trade barriers was also backed by the industry's threat to go public against the entire FTA, a threat Ottawa took seriously.... [T]he beer industry possessed a real public relations capacity to seriously embarrass the government with an anti-free trade campaign. The industry prevailed.[355]

While there is little doubt that the threat of the beer industry publicly pillorying the FTA was something that Canadian federal trade officials and their political masters preferred not to have to deal with, brewer efforts were likely not what led Canadian and US negotiators to leave beer for the most part out of the treaty. It is more plausible that both Canadian negotiators and their US colleagues understood that there was an EC Panel underway which was already looking into provincial liquor board policies. Given that both parties to the CUSTA retained their GATT rights, it would no doubt be a short time before beer issues were sorted out in that arena. Moreover, it could be accomplished without having to face down Canada's brewers in a public row tied to the CUSTA discussions.

So, rather than characterizing the CUSTA discussions on beer as a situation where industry threatened and Canadian federal government negotiators blinked – it was more akin to what happens when a hockey enforcer is playing in a close game but also has a score to settle with a member of the opposing team.. He takes the opposing player's number and waits for a more opportune moment in the next match to do what he feels must be done. Clearly this was the Canadian federal government's strategy as Track 2 developed in earnest soon after the CUSTA process was completed. These developments will be discussed in more detail in Chapter 6.

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demands and built many more breweries than the Canadian market could possibly require. Now they wanted these plants to be protected. The Americans went along. I did not regard this as a negotiating triumph."

[353] This has been denied by some of Canada's negotiators. However, it is confirmed by a number of accounts in the primary literature. As well, it has been confirmed via interviews with a number of US officials who were involved in the talks.

[354] Johnson (1994 p. 216) describes the terms of the deal relating to beer as follows: "FTA 1204 provided that the national treatment obligations in Chapter 5 [which dealt with wine, beer and distilled spirits] not apply to measures related to the internal sale and distribution of beer and malt-containing beverages existing on October 4, 1987, provided that they were not made more non-conforming. FTA 1205 set out an unqualified reservation of GATT rights."

[355] Doern and Tomlin (1991 p. 79)

Analysis:

As noted previously, this analysis does not seek to supplant the statist explanation of Canadian foreign policy. The focus is instead to build on the statist perspective's already powerful analytical capabilities so that it would more fully and accurately capture the essence of events. To accomplish this task, the statist position will be deployed first to see if it explains the events of the EC dispute – or Track 1 - and the nascent stages of the US dispute – or Track 2.

If the statist position cannot provide an adequate explanation on its own, then two alternative hypotheses, which are intended to test the efficacy of the epistemic communities approach, will be assessed to see if they can help complete the picture. To recall, these hypotheses are:

1. An epistemic community comprised of trade officials from Canada's DFAIT and the USTR was operating during the Canada-US beer disputes, and;
2. This epistemic community had a determinative impact on policy outcomes in the Canada-US beer disputes.

On reviewing the events of Tracks 1 and 2 as set out in Chapter 5, it is clear that much that happened can be explained by the statist position. For example, it is evident that both the EC and the US engaged Canada in dispute settlement procedures largely because of pressures from their domestic industries. There was little cost to either the US or the EC in pursuing the matter through trade dispute settlement procedures and bilateral negotiations, and there was much for their industries to gain if provincial liquor boards were forced to permit greater entry to Canada of EC and US wine, spirits and beer on more favourable commercial terms.

Moreover, the response to these entreaties by Ottawa no doubt appeared to both the EC and the US as just more of the daily bump and grind of trade relations. Given the relative size of the alcohol sector in Canada, it was clear to both countries that Canada was not going to expend a great deal of political or economic capital in facing down their challenges. Thus, an analysis that focused only on rational utility calculations of the material interests at stake for the EC and the US should yield the outcomes recounted in the case study data.

Much of Canada's reaction can be similarly explained. Foreign governments were attacking Canadian industries, and there was a need for Ottawa to respond appropriately or face the domestic political consequences of failing to act. However, given the size of the domestic alcohol industry in Canada as compared to the potential impact of having EC and US markets denied to much larger Canadian sectors like agriculture and softwood lumber, Canada's reaction needed to be judged by most observers as proportional to the threat level it faced. Consequently, Ottawa too appears to have acted in a manner that, in the main, statism explains. However, there were also clearly another set of dynamics influencing Canada's responses to the US and EC incursions. They can be attributed to the impact of specific beliefs held by DFAIT trade officials – and sanctioned by their political masters, who also held many of the same beliefs – about the most appropriate way for Canadian industrial policy to evolve. These beliefs had a determinative impact on decisions made by Canada during the events covered in Chapter 5, and suggest that there was an epistemic community operating amongst officials at DFAIT during the beer disputes.

This group of DFAIT bureaucratic officials satisfies Adler and Haas definition of an epistemic community in that it was:

- An identifiable group
- Operating on the basis of shared beliefs and ideas
- Widely recognized as having expertise that allowed them to influence both policy-makers and the policy-making process; and
- Able to in fact influence the policy process.

The group identity component of Canada's DFAIT trade officials was partially defined by the fact that most of the negotiating team worked for the same department. Points three and four above are also satisfied by the institutional status of the various officials. That these officials were employed by DFAIT as trade negotiators meant they were recognized as experts both within and outside of government. This official status also allowed these specific DFAIT bureaucratic officials attached directly to the beer dispute to have enormous influence over the policy process.

How these officials were able to affect the foreign policy decision-making process merits further discussion. As noted in Chapter 2, political officials are not insignificant to the policy-making process. On matters that political leaders choose to engage directly, they hold sway over how the foreign policy course for a country like Canada will be plotted and subsequently followed. However, much of the foreign policy decision-making process does not involve the active participation of political officials. While politicians may set the course for a country's foreign policy, it is invariably up to bureaucratic officials to manage day to day events. In this way, bureaucratic officials were afforded the 'political space' to shape foreign policy decision-making at this stage of the beer disputes.

As will become clear in the chapters that follow, the participation of political officials in the beer disputes was sporadic.[356] As one industry representative interviewed for this dissertation noted:

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[356] Interestingly, the only subjects interviewed for this dissertation that disagreed with this characterization were the Canadian federal trade bureaucrats themselves. For example, one indicated that (Dissertation interview): "Everything that we did in the disputes was signed off by Ministers. The negotiating instructions came directly from cabinet. For the US, it would have been the same." This is interesting when compared to the observations of an industry representative (Dissertation interview): "The role of elected officials was minor. There was no clear political champion on either side. The process was led for the most part by senior bureaucrats – politicians just gave their endorsement." Both observations are probably correct in the minds of the individuals who made

> There was little political involvement in this dispute. If politicians were involved, it was more in closing the deal. The politicians weren't into the 'nitty gritty'. They just told the bureaucrats to fix it – and they ran with the ball.[357]

Most of the decision-making in fact occurred at the bureaucratic officials level and was in reaction to day-to-day events associated either with the Panel process with negotiations between the various parties involved. It was the trade officials in the Canadian federal bureaucracy that steered these events for the most part – not their political masters. Moreover, the direction in which they steered events was guided by a set of shared beliefs about a series of interrelated issues.

By uncovering these beliefs – point 2 in the Adler and Haas definition above - it becomes possible to gauge the impact of this epistemic community of DFAIT bureaucratic officials on events. Moreover, it was the fact that these beliefs were shared by DFAIT and USTR bureaucrats – what Adler and Haas refer to as 'policy diffusion' – that drove much of the decision-making in Canada and the United States on the beer dispute.

Chapter 5 provides evidence that there was a widely shared perspective at DFAIT on how both Canada's international trade relations and its industrial policy should operate. The cornerstone of this view was that open borders to trade were preferable to protectionism, and that Canadian trade barriers shielding non-competitive industries should be dismantled as quickly as practicable. While it was acknowledged that it might be politically painful in the short term for these steps to be taken, it was felt that the competitiveness of the Canadian economy would be enhanced in the end.[358]

That DFAIT officials held this perspective is borne out by many of the interviews conducted for this study. For example, in answer to the question "What is your view on the issue of open borders to trade?" two DFAIT negotiators involved in the alcohol beverage disputes responded:

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them. The reason is that whereas a bureaucrat would suggest that *pro forma* political approval constituted 'political oversight' and 'instructions', the industry member would see it as window dressing that had little practical impact on the course of events.

[357] Dissertation interview.

[358] A DFAIT official interviewed for this dissertation recounted this view (Dissertation interview): "The role of government should be to allow industry's to adjust. The workers that do not make it in the transition should be given assistance to move on to something else. However, the most important thing is that governments shouldn't protect non-competitive industries forever." This focus on adjustment is an interesting one. In the aftermath of CUSTA there was a widely held belief that the most notable shortcoming of the agreement had been the lack of a complementary package of adjustment assistance to ease the burden of transition. This particular official was no doubt aware of this criticism and therefore mentioned adjustment assistance to demonstrate that just because he supported free trade did not mean that he was interested in callously tossing industries and workers on the scrap heap.

> Overall it is a positive approach that governments should consider.[359]
>
> "I've been in favour of it for a long time. In fact, it I hadn't been in favour of free trade, I wouldn't have graduated from the university that I went to out West [Western Canada]."[360]

That two Canadians could be interviewed and respond favourably to a question on free trade is not unusual given the fact that close to half of Canada's population supported it as demonstrated by the electoral results of 1988.[361] This election was fought largely on the free trade issue – with the Progressive Conservative government supporting it, and the Liberals being opposed. However, that two DFAIT officials replied in this fashion is more remarkable as the history of trade policy at DFAIT had traditionally been one of supporting 'managed' trade as opposed to free trade.

To DFAIT multilateralists – and to their political masters during the Trudeau years and before - free trade was more or less code for lowering borders with the US. This was something that both DFAIT multilateralists and federal Liberal party politicians were loath to consider as they shared an almost canonical perspective that the Canadian economy would be swept away by cheap American goods if free trade were permitted.[362] However, with the ascendance of free trade supporters at DFAIT during the Mulroney years, [363] the logic of the need to render the 49th parallel more permeable became almost received wisdom for many departmental staffers.[364] Accordingly, it should not be surprising that two of the senior Canadian officials involved in the EC Panel discussions on alcoholic beverages shared a view on the importance of fostering free trade.

Officials promoted to positions of prominence at DFAIT during the Mulroney years tended to favour closer ties with the US and the dismantling of what they considered as a general reliance on 'protectionism' in Canadian industrial policy. These officials had a view of the economy and Canadian trade policy that interlocked with the prevailing 'free trade' perspective that was widely held in the Mulroney Tory government. Therefore, they had a protective umbrella of political support in the post-CUSTA environment. To these bureaucratic officials, that the Canadian brewing industry was protected by provincial liquor board regulations was anathema to how Canada's industrial policy should operate. To correct the problem, these Canadian trade bureaucrats believed that elements of the US regulatory model for alcoholic beverages represented better public policy.

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[359] Dissertation interview.

[360] Dissertation interview.

[361] Doern and Tomlin (1992 p. 238) report that the results of the popular vote for the November 1988 election were "… 43 per cent for the Conservatives, 31.9 per cent for the Liberals, and 20.4 per cent for the NDP, with the Reform Party and others garnering the remainder."

[362] The tenor of this period is described by Hart (1994 p. 16) as follows: "A number of Canada's federal government policies adopted in the 1970s … [were] … directly attributable to the views of economic nationalists…. Many of these polices had first been suggested in the 1957 report of the Gordon Commission. They included: trade diversification (the third option), review of foreign investment proposals to determine whether they promised significant benefit to Canada (FIRA), Canadian control of the energy industry (NEP), and an industrial policy (DREE, then DRIE, and all the programs delivered by these two departments)."

[363] For example, see: Doern and Tomlin (1991); Ritchie (1997) and Hart (1994).

[364] For a useful overview of Canadian trade policy see: Hart (1994 pp. 13-35)

The view of DFAIT officials on the Canadian beer industry was thus very similar to the perspective set out by economists' Irvine, Sims and Anastasopoulos in the following passage:

> In the [Canadian] brewing industry, the existence of scale economies at very high output levels indicates that the purpose of maintaining small breweries in some provinces is to ensure local employment. In contrast to the high level of protection of the Canadian industry, there is little evidence of substantial state or federal protection of the US brewing industry, at least with regard to Canadian products. This attitude is due to its national scope, the lack of any apparent threat from Canadian producers, and the distribution system that dominates in most US states. Thirty-two states (including New York and California) and the District of Columbia, unlike all ten Canadian provinces, have non-monopoly distribution systems. Prices in these states tend to be dominated by market forces and are not generally subject to differential markups.[365]

So, these Canadian trade bureaucrats believed that Canada's brewing industry is protected by regulation and, therefore, bloated and uncompetitive, and, by contrast, Adam Smith's invisible hand controls activities in the US brewing sector to a much better public result. Accordingly, the US industry model is a superior one and is the archetypal structure to which Canada's brewers should aspire.

A second conviction prevailing amongst Canadian federal trade bureaucrats involved in the beer disputes was that the Canadian brewing industry was able to avoid its comeuppance during the CUSTA period because of political pressure that brewers were able to exert with political officials during a sensitive time.[366] As one DFAIT official noted in an interview for this study:

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[365] Irvine, Sims and Anastasopoulos (1990 p. 335). Beer II demonstrated that the US beer sector is not as influenced by pure 'market forces' as Irvine, Sims and Anastasopoulos would seem to believe.

[366] As a DFAIT official noted in an interview for this dissertation (Dissertation interview): "The Canadian beer industry had enormous influence on both the provincial and federal levels of government. And, the brewers pulled out all of the stops to be kept out of the FTA." Another DFAIT official indicated (Dissertation interview) that "While the brewers had minimal influence with the

> The Canadian beer industry was able to maneuver politically to get itself exempted from the FTA. However, it was a Pyrrhic victory as Canada's GATT obligations were still there.[367]

Now that the EC Panel and the subsequent pressures from the US had permitted the fight on beer practices to be joined again, there was an opportunity to go back and correct the mistake that had been made by exempting beer from the CUSTA.

A third belief was that the continuation of interprovincial trade barriers (IPBs) was a significant impediment to Canada ever evolving into a world-class competitive economy. Moreover, if ever there was an instance in the Canadian economy where IPBs were readily in evidence it was in the alcoholic beverage sector.

As noted above, despite this point of view on IPBs being widely held amongst DFAIT bureaucrats, and their political masters, Ottawa had proven woefully ineffective in pressing the provinces to strike a deal to dismantle these barriers. Hence, a GATT Panel ruling against a number of provincial regulations on alcohol policy was a blessing in the minds of Canada's trade bureaucrats as it could be leveraged to force action on the IPB file.[368]

A fourth judgment shared by many of the DFAIT negotiators was that the EC Panel – which became the touchstone for interpreting the trade legality of provincial liquor board practices - was essentially correct in many of its conclusions about the protective nature of the commercial practices of the provincial liquor boards. For example, on the question "Did Canada have a legitimate case under international trade laws for sustaining provincial liquor board practices?" some of the members of the Canadian negotiating team interviewed for this study answered as follows:

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public, they had a large degree of influence with Canadian politicians during the CUSTA discussions." He goes on to suggest that (Dissertation interview): "Canada's brewers shouldn't have been exempted from the CUSTA. It was done at the behest of the beer industry and came as a result of a trade-off for US sugar." This "trade-off for sugar" view has been a hotly contested issue amongst the many stakeholders involved in the beer disputes. While DFAIT officials have never confirmed this version of events officially, that it happened is established by several officials from both Canada and the US who were involved in the CUSTA negotiation. As a US official who was "in the room" when the deal occurred summarized (Dissertation interview): "Both Canada and the US decided for domestic political reasons to pull certain things off of the table. Ottawa was under enough pressure by the brewing industry that when the US pulled sugar off the table beer was at the top of the list for Canada. It topped Canada's list because of effective lobbying by the brewers. It is important to note that it wasn't a direct trade *per se*, but when the US pulled sugar Canada responded with beer."

[367] Dissertation interview.

[368] While the reference relates more to a later period in the beer disputes, there is a notation in the BAC files (BAC internal memo. 17 May 1990) as follows: "External and XXXX [a senior Federal official involved in IPB discussions] have encouraged the US to 'raise a stink' over beer at the May 18 meeting of the US-Canada Binational Commission."

> "I don't believe so. And, in my mind, the GATT Panel confirmed it."[369]
>
> "Didn't the GATT hear this?"[370]
>
> "No. Provincial liquor boards took liberties in interpreting social policy to protect their industries."[371]
>
> "All the practices that were cited by the Panel were clearly discriminatory – and there were also bad economic rationales for doing them. Canada didn't have a leg to stand on."[372]

These were the views of the DFAIT officials charged with formulating Canada's response to the GATT challenges on provincial liquor board practices. It is little wonder then that the provinces and the alcohol industry stakeholders were suspicious about the depth of Ottawa's commitment to defending their interests.

One brewing industry representative interviewed for this study goes so far as to suggest that there may even have been collusion between Canadian trade officials and their US counterparts in the CUSTA talks that resulted in the US Section 301 complaint on beer. In answer to the question "Do you believe there was a *quid pro quo* between Free Trade negotiators in Canada and the US that in return for beer being exempted from the CUSTA, Canada would not resist the US pushing a Section 301 in the GATT?" the brewing industry representative answered:

> Yes I believe so. There is no doubt in my mind that the Canadian negotiators indicated that if the US wanted to pursue an action on beer that it was entirely their prerogative.[373]

Interestingly, a US trade official who was later involved in the beer disputes also shared this perspective, though speculatively. He indicated in his answer to the same question that:

> Yes, I think there may well have been some collusion. It is certainly plausible.[374]

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[369] Dissertation interview.

[370] Dissertation interview.

[371] Dissertation interview.

[372] Dissertation interview.

[373] Dissertation interview.

[374] Dissertation interview. However, it is important to note that most of the officials who were interviewed for this dissertation denied that there was any kind of understanding between Canada and the US.

It was into this charged environment that the US embarked on its own GATT challenge of provincial liquor board practices. However, this challenge was to focus specifically on beer.

The following chapter recounts developments on Track 2 of the beer dispute, and examines how the various shared beliefs set out above operated to affect the foreign policy decision-making process in both Canada and the United States.

Chapter Six

Beer 1 Begins

Introduction:

This chapter begins by reviewing the response of Canada's brewers to the winds of change signaled by the EC Panel Report and the CUSTA. The most significant measures taken by Canada's brewers were: the merger of Carling-O'Keefe Breweries with Molson Breweries; deep cost-cutting initiatives; and, aggressive lobbying with provincial regulators – particularly in the Province of Ontario – to shore up regulatory preferences for Canada's domestic brewers.

Chapter 6 moves on to examine the meteoric growth of imported US discount beers in Ontario, and the response of the Ontario government to limit the damage caused to domestic brewers. Ontario's actions subsequently precipitated a GATT Panel challenge by the US on regulatory practices governing beer in all provinces.

Chapter 6 will also review the initiation of a Section 301 process by US-based Heileman Brewing Company, and the responses of Canada's federal government and Canada's brewers to the complaint.

The chapter will conclude by testing the explanatory capabilities of the statist perspective against these events. As in Chapter 5, while the statist model can explain much of what occurred, there are a number of situations where a rational assessment of material capabilities fails to elucidate all that happened. In these instances, the epistemic community approach helps to complete the picture.

Canada's Brewers Respond

Canada's brewers were forced to adjust their business models to respond to the new reality presented by the EC Panel report and CUSTA. The provincial regulatory protections that the brewers had enjoyed were now exposed, and Canada's brewers were forced to contemplate a future where they might have to face US competition head-on.

The reaction of Canada's brewers to these new circumstances was consistent with the general history of industrial development in the Canadian brewing sector touched on in Chapter 4. To enhance their ability to compete against lower cost US imports, Canada's major brewers sought to consolidate the Canadian domestic industry and rationalize production. The brewers also focused on lobbying provincial governments and liquor boards to shore-up regulatory protections that may have been compromised by the EC Panel.

The most substantial development in this rationalization and consolidation effort was the 1989 merger of Molson Breweries and Carling-O'Keefe Breweries, two of Canada's three largest brewers. Molson and Carling recognized that, operating individually, they had far too much brewing and packaging capacity as well as administrative, marketing and sales complexity to compete on a cost basis with US brewers. Should the regulatory environment be dismantled by trade actions – which both Molson and Carling believed was likely to occur in the future – their prospects for survival could be enhanced significantly by combining operations and then restructuring to reduce capacity and complexity under the leadership of a single management team. If they failed to act, a precipitous change in the regulatory environment would certainly cripple, and could potentially be fatal to both companies.

The Molson Breweries – Carling-O'Keefe Breweries merger was followed by an immediate downsizing of the new business. For example, whereas Molson and Carling had a combined 16 breweries operating before the merger, only nine remained by the time the initial phase of the restructuring was complete in 1992.[375]

Nevertheless, it is important to note that even with this dramatic reduction in production capacity, the new venture – which retained the name 'Molson' – was still unable to approach the cost efficiencies of the largest US brewers, which operated on a national basis.

Interprovincial trade barriers meant that the only restructuring Molson could contemplate was on a province-by-province basis. So, if a province had a brewery from each of Molson and Carling, one was closed and the other retained by the new organization.

A more efficient model would have seen Molson shipping product between provinces and, as was to occur later when an IPB agreement was struck, the establishment of regional operations to serve multiple provinces. However, given regulations existing in all provinces that essentially prohibited interprovincial shipping, Molson could not achieve these efficiencies in the first phase of its merger process.[376]

This highlights a dilemma that had a significant impact throughout the trade dispute process. While Canadian brewers were prevented by provincial regulations from shipping beer between provinces and thus developing the national economies of scale required to compete on a cost basis with the largest US brewers, these same barriers operated to both enhance Canadian brewers' profitability and prevent US brewers from entering the Canadian market in a meaningful way.

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[375] For a review of the downsizing associated with the Molson-Carling merger, see: Irvine and Sims (1994 pp. 6-8).

[376] A number of provinces did permit interprovincial shipments of beer. However, this beer was considered to be 'non-domestic' and therefore received the same punitive regulatory treatment as foreign product. Consequently, it was financially impractical for Canadian brewers to consider shipping any significant volume of beer interprovincially.

Canada's brewers were thus whipsawed when it came to formulating positions on trade barriers. If brewers supported their retention, they denied themselves the cost efficiencies of having a national infrastructure. They also risked being labeled as 'protectionist,' an unpopular position in an era that favoured lowering trade barriers generally. Alternatively, if the brewers favoured trade barrier reduction, they could realize cost efficiencies, but risk being exposed to competition from foreign brewers, as well as having to bear the investment costs associated with adjusting infrastructures to operate in the new conditions.

An additional level of complexity was that both Molson and Labatt were publicly traded. While on its face reducing trade barriers may seem a position for which capitalists would have a natural affinity, the opposite is often the case. Trade barrier reduction leading to enhanced competitive pressures and demands for investment would undoubtedly drain a company's cash flow, something that the market responds to negatively. This would make it more difficult for the brewers to raise capital to invest in the operational changes needed to compete.

A further complication affecting Molson was that Canada's Competition Bureau had reluctantly permitted[377] the Molson-Carling merger to proceed – whereas it had blocked a previous similar proposal[378] - at least partially because of a submission by the merging companies suggesting that a reduction of both international and interprovincial trade barriers was inevitable. In approving the Molson and Carling merger, the Bureau stipulated that the new Molson would have to do all that it could to further the reduction of interprovincial trade barriers.[379]

Because of these contradictory impulses, the individual brewers' positions on trade barrier reduction were often schizophrenic. This would have the affect of compromising the Canadian brewing industry's effectiveness with both the public and federal and provincial government officials involved in the trade dispute settlement process.

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[377] The rapport between Canada's national brewers and Canada's Competition Bureau has generally been one of suspicion and mistrust. The relationship is shaped by a fundamental belief held by various officials at the Bureau over the years that provincial regulatory regimes have created a fundamentally 'uncompetitive' market for beer in Canada that benefits disproportionately Labatt and Molson at the expense of smaller brewers and consumers.

[378] The Competition Bureau had blocked a similar request by Labatt in the early 1980s to combine its operations with Carling-O'Keefe.

[379] The Competition Bureau took steps to hold Molson to this commitment. For example, in a 1990 meeting between Canadian federal government trade officials and the brewing industry that was also attended by a representative from the Competition Bureau, a representative from Molson was questioned on the company's view about reducing trade barriers. When the Molson representative failed to give a convincing endorsement of the need to dismantle IPBs, the Competition Bureau official reported the equivocation back to his superiors. This resulted in a call from the Competition Bureau to the President and CEO of Molson suggesting that there was a need for Molson to take a more aggressive public stance on the importance of eliminating IPBs in the brewing sector.

Despite the limitations caused by IPBs in the beer sector, the results of the Molson-Carling merger were impressive. Because of the merger, the new Molson had reduced excess capacity and was able to employ its remaining network of breweries more efficiently. At the same time, it was able to increase industry concentration, which had the affect of reducing some of the pressures in the marketplace that were affecting profitability.[380]

The net effect of these changes was so dramatic that Canada's Conference Board argued in 1990, somewhat prematurely given what was to occur in subsequent years, that there were probably only limited savings to be had from further reducing interprovincial trade barriers.[381]

In addition to closing breweries,[382] both Labatt, which was displaced as the leading Canadian brewer by the merger, and Molson began an aggressive campaign of cost cutting. For example, Labatt reduced its costs by close to ten percent. This was driven by a work force reduction of 17%, a lowering of packaging, distribution and administrative costs, and an increase of productivity that topped 24%.[383]

As well as making these significant changes to their operations, Canada's brewers, individually and through the BAC, increased their lobbying efforts to shore up the regulatory environment.

Stanching the Flow of US Beer into Ontario

As a result of the EC Panel Report, DFAIT requested that provincial liquor boards conduct audits to ensure that any differential cost-of-service charged to foreign beer was for the express purpose of recouping the expense of carrying that beer, plus a reasonable margin of profit. Each provincial liquor board took on this exercise in its own way – with some hiring third party audit firms, and others using the offices of their provincial Auditor's General to do the work. [384]

The LCBO (Liquor Control Board of Ontario) selected Clarkson Gordon to review its service charges for foreign alcohol products in Ontario. The auditors undertook to provide a detailed methodology review as well as an audit certificate with respect to the cost of service differentials between imported and domestic alcoholic beverages sold by the LCBO.[385]

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[380] Irvine and Sims (1994: p. 8)

[381] The Conference Board notes (1990 Executive Summary) that: "The results of the study indicate that, following the Molson-Carling merger, liberalization of the interprovincial trade in beer would have only a limited impact on the structure of the Canadian brewing industry. The analysis suggests that, at most, three additional plants would be closed." The Conference Board was too conservative in its estimates of plant closures. Labatt closed 4 breweries in the 1990s (Saskatoon, St. John, Winnipeg and Kitchener). Molson later closed additional facilities in Barrie, Winnipeg and Regina.

[382] Labatt had responded by reducing its breweries from twelve to nine (and later went down to eight.)

[383] Wood Gundy (1995 p. 6)

[384] Clarkson Gordon (1989 pp. 2-3) defines cost of service differential as "… the additional or excess costs incurred by the LCBO in purchasing, warehousing, handling and sale of an imported product over and above the costs of purchasing, warehousing, handling and sale of a domestic product."

Developments in the Ontario marketplace occurring contemporaneously with the launch of the Clarkson Gordon exercise added an additional level of complexity to the audit process. Lack of precision in the LCBO cost-of-service policy, as well as a desire by the LCBO to increase its share of the beer retailing business,[386] had resulted in US discount beer enjoying unprecedented success in Ontario.[387] Consequently, Canada's brewers looked to the audit process not only to entrench liquor board policies that were already in place in Ontario, but they also hoped that it would close the gaps that US brewers were exploiting to fuel growth.

Having experienced the impact of cheap US imports on their businesses in the West,[388] further seeing that the LCBO was conflicted and likely not supportive, and also that the audit could probably not be completed before irreversible damage occurred, Molson and Labatt took aggressive political action.

During a BOO (Brewers of Ontario) meeting with Ontario Treasurer Robert Nixon on 27 February 1989,[389] Molson and Labatt argued that if something were not done, their projections indicated that US brewers could capture 4-5% of the Ontario market within a year. They were careful to indicate that this would not only be a devastating blow to Ontario's brewers, but to Ontario's coffers as well.

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[385] Clarkson Gordon (1989 p. 1)

[386] That the LCBO was encouraging the sale of US brands is confirmed by the following Canadian Press Newswire story (CP Newswire 19 June 1989): "Sales of such brands as Old Milwaukee, Milwaukee's Best, Meister Brau and Lone Star were up 800 percent in May over the same month last year, Don Lawson, category manager for the LCBO said Monday. 'I guess you could call it a windfall for us,' Lawson said. Any time you have an increase in sales, you've got an increase in profits.' Lawson said sales of the US beer is 'price driven', noting some of the brands cost about $2.00 less than Canadian brands for a six pack of cans."

[387] Generally, US beer at discount prices had not attracted the interest of Ontario beer drinkers – usually capturing only about 0.5% of the market. However, in 1989, the price gap between regularly-priced Canadian beer and US discount product grew to such an extent (the LCBO was offering US beer as low as $4.45 a 6-pack vs. $6.55 for domestic beer – $2.10, or 32% below the prevailing Ontario price) that US brewers captured close to 2% of the Ontario market almost overnight.

[388] Scotia McLeod (1990 p. 19) describes the situation in Western Canada as follows: "Whilst imports of US beer into Canada in 1988 were 1.45% of total Canadian sales they were about 9% of total sales in Alberta, 7% of total sales in BC, and 2% of total sales in Ontario and a negligible amount in Quebec. The significant penetration of the BC and Alberta markets by US beer began in 1980 with industry-wide brewing strikes in BC (July-September 1980) and Alberta (July 1980-February 1981) and was reinforced by another industry-wide strike in Alberta in 1985. The high acceptance of canned beer in these provinces no doubt provided a hospitable environment for the US product."

[389] The Brewers spread their lobbying net widely. For example, representations to the Ontario Tories elicited questions for the Liberal government in the Legislature (Bill Walker. 'LCBO chief urges floor price for US beers.' Toronto Star, 17 May 1989): "The issue was raised in the Legislature yesterday by Progressive Conservative MPP Bob Runciman (Leeds-Grenville), who said consumers are 'being lured to LCBO stores to purchase imported beer because of the LCBO's preferential treatment given to imports.'"

The brewers pointed out that each time the LCBO sold a six-pack of low-price imported beer, the Provincial Treasury lost up to $1.10. Moreover, if market penetration of US discount beer in Ontario followed Western Canadian trends, it could mean a loss of $50 to $108 million in Direct Tax Revenue per year to Ontario.[390]

Foreseeing potential criticism that Ontario's brewers had simply priced their product too high to consumers and that if they really wanted to compete they could discount too,[391] BOO claimed that there were a number of additional factors in Ontario's regulatory environment preventing domestic brewers from matching US imports on price.[392]

To address these issues, BOO proposed that the Ontario government implement a series of changes to LCBO pricing policies, including: Imposing a service charge of $1.20 per six pack for imports to ensure comparability with the service costs and requirements facing domestic brewers; establishing a minimum net return of $1.79 per six pack to the Provincial Treasury for imports; and extending container deposits to imported beer at the same level paid by domestic brewers.[393]

The Ontario Liberals announced a new series of policies for managing beer taxation on 5 July 1989. Treasurer Robert Nixon stated to the Ontario Legislature that:

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[390] Brewers of Ontario presentation to the Hon. Robert Nixon, Ontario Treasurer, (27 February 1989).

[391] Treasurer Nixon knew that this criticism might be raised, so he protected himself by making public statements to the effect that Ontario's brewers had to do their part to offer a better deal to consumers if they wanted to compete with US products. For example, in an interview with Richard Mackie of the Globe and Mail ('Cut prices to beat competition from US, Nixon tells brewers' Globe and Mail 31 May 1989) Treasurer Nixon said that: "The big Canadian brewers should cut the prices they charge for six-packs of beer, instead of complaining about US beer taking over their markets.... 'They're worried about competition and I think they might compete a little more effectively....' 'It seems to me that our local brewers might very well sharpen their pencils, particularly on six-packs which is where they are losing the market, and try and compete with the American beer."

[392] Specifics included (Brewers of Ontario presentation to the Hon. Robert Nixon, Ontario Treasurer, 27 February 1989):

- Up front, Ontario brewers pay 73 cents per 6 pack to the LCBO to defray the Board's costs of retailing its products. The LCBO imposes no such service charge on imported beers.
- Ontario brewers provide and pay for all warehousing, inventory, and transportation costs to deliver their beer directly to LCBO stores at no cost to the LCBO. In the case of imported beer, the LCBO provides for and absorbs the costs of these services.
- The costs of warehousing, distributing and retailing Ontario beer are subject to provincial markup taxes, which taxes return approximately $40 million annually to the Ontario Treasury. The costs of warehousing, distributing and retailing imported beers provided as they are by the LCBO, are not subject to provincial markup taxes.
- All Ontario beer whether sold by the LCBO or Brewers Retail is subject to a container deposit which, although refundable, does increase the initial purchase price of Ontario beer to Ontario consumers ($0.10/bottle and $0.05/can). Imported beers enjoy a price advantage because they are exempt from deposit charges and are not responsible for the direct cost of disposal.
- Ontario brewers support and pay for many initiatives which actively promote the socially responsible use of alcoholic beverages. Imported beers are not subject to these requirements and do not bear the costs of supporting them.

[393] Brewers of Ontario presentation to the Hon. Robert Nixon, Ontario Treasurer. (27 February 1989).

> These changes are being introduced in the context of a comprehensive review of Ontario's beer pricing policies, including both pricing mechanisms and taxation. The review is now underway to ensure that the demands of the market place and the consumer's range of choice are recognized in the policy framework.[394]

The new policy established minimum returns to the Ontario Treasury for all beer sold in Ontario, regardless of distribution vehicle; (greater of 82% markup or cost of service plus $0.21 per litre for imports; greater of 23.2% *ad valorem* (value added) fee or $0.21 per litre for domestic beer sold through BRI and same for LCBO sales plus $0.606 per litre service cost). It further maintained both the 82% LCBO markup on all imported beer and the 23.2% *ad valorem* tax on Ontario produced beer.

The Treasurer also imposed a cost of service on all beer sold in Ontario by the LCBO. For imported beer, the charge would be $0.874 per litre. The charge on Ontario beer would be set at $0.606 per litre. Lastly, a maximum cost of service fee of $2.35 was applied to all package sizes sold by the LCBO.[395]

The Brewers of Ontario's were delighted that their proposal to the Treasurer had been adopted virtually *in toto*. The immediate result was that prices on US 6 packs increased from $4.70 to $5.40 over night.[396]

Moreover, important policy changes were implemented without having to wait for the Clarkson Gordon audit to be completed. As noted above, Ontario's brewers had been concerned that the audit was not proceeding quickly enough to interdict the growth of US imports before they established a firm beachhead in Ontario.[397] Things had worked out so well, in fact, that BOO cautioned its members to be very careful in their communications on the changes lest they goad Washington to action.[398]

Unfortunately for Ontario's brewers, the LCBO was not as prudent. Because of a precipitous drop in US sales resulting from the new pricing structure, the LCBO chose to cancel a significant order for Stroh product.[399] Stroh's reaction was predictable.

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[394] Statement to the Ontario Legislature by Robert F. Nixon, Treasurer of Ontario and Minister of Economics, on Beer Pricing. (5 July 1989, p. 1)

[395] Brewers of Ontario memo. (5 July 1989)

[396] Brewers of Ontario memo. (5 July 1989)

[397] In fact, the audit would not be published until October 1989.

[398] BOO instructed its members as follows (BOO memo 5 July 1989): "In announcing these changes to the tax structure for beer, Mr. Nixon has taken the high road citing the need for Ontario to fully recover its costs and ensure that it gets a fair return on all products sold. However, because these changes will be closely scrutinized by our trading partners, many of whom will regard them as protectionist, I would ask that members refrain from making any comments to the press at this time."

The US Responds

The Treasurer's announcement and the resulting cancellation of its order by the LCBO infuriated Stroh. Confident that Ontario consumers would be similarly outraged if they knew about how the Ontario government had come to deny them access to lower priced beer, Stroh produced a newspaper advertisement vilifying the new policy. Stroh also bought space in a number of Toronto-based newspapers to run the advertisement.

However, Ontario liquor legislation required that any beverage alcohol advertising be approved by the LLBO (Liquor License Board of Ontario) before it could appear in public. Stroh submitted its advertisement to the LLBO for consideration. The LLBO turned the Stroh advertisement down as being inconsistent with the Board's advertising rules.[400]

Frustrated by a situation that must have appeared to border on Kafkaesque absurdity, Stroh redrafted its already existing Section 301 petition to reference the changed circumstances in Ontario, and moved to submit it to the USTR for consideration. But, it soon learned that its old partner in stalking provincial liquor boards, Heileman, was considering doing the same – though Heileman was more concerned about practices in Western Canada.

Adding further impetus to Stroh and Heileman's interest in breaking down regulatory barriers to growing their presence in Canada were the difficulties both were facing in the US.[401] As Scotia McLeod noted at the time:

> Heileman and Stroh are … in trouble. Stroh's volume has ebbed away quickly in 1989, and Stroh – a private company – may be broken up. Coors announced its intention to acquire most of Stroh's brewing assets but then backed away. The situation is still fluid.

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[399] Stroh noted in the Executive Summary to its Section 301 submission (Stroh Draft Section 301 Submission to the USTR, 24 July 1989) that: "The pricing changes have already substantially impacted US breweries. For example, the LCBO has indefinitely deferred official orders with the Stroh Brewery Company for 413,000 cases of product originally destined for delivery in mid-July 1989." In addition, (Stroh draft Section 301 Submission, 24 July 1989 p. 4): "…[O]n June 15, 1989, the Stroh Brewery Company received notification that its promotional materials, specifically point of sale displays, were to be dismantled …. This withdrawal of a $40,000 Old Milwaukee display program in Ontario liquor stores is evidence of a de-emphasis of retail display activity for United States beer."

[400] Letter from Stroh attorneys Baker and McKenzie in its Section 301 submission to the USTR. (24 July 1989).

[401] Despite their difficulties, Stroh and Heileman were significant brewers. According to BAC estimates, Stroh production capacity was 22,178,242 hls. and Heileman was 12,900,000 hls. Both were significantly larger than either Labatt or the new Molson.

> Heileman, like Stroh the product of many mergers, was itself acquired by the Bond Corporation, of Australia, in 1987, since which time it has incurred significant losses, not least because of the $800 million of LBO [Leveraged Buy Out] debt with which it is burdened. Heileman's poor financial condition and substantial losses may cause it to follow Stroh into limbo in 1990.[402]

Stroh and Heileman met together with representatives of USTR on 24 July 1989 to review potential response options. At this point, the breweries had not yet decided whether to file a complaint, or if they were to pursue it, whether to go separately or together, or in concert with their national trade association, the Beer Institute. Moreover, they were not settled on whether to attack the practices in all provinces, or focus on a single provincial liquor board. Lastly, should they decide to launch a challenge, a choice had to be made as to whether to press it through the new CUSTA dispute settlement procedure, or through the GATT.[403]

Running out of options and time in the US, and losing overnight a potential source of growth in Ontario, Stroh determined that it could not wait to agree on a common position with Heileman or any other potential stakeholder. Stroh decided instead to move independently to launch a Section 301 complaint in July 1989. The focus of its draft petition was the recent pricing and cost of service changes in Ontario.[404]

In its draft petition, Stroh charged that Ontario's new policies had nothing to do with the LCBO recouping its costs for handling US beer. Rather, they were a result of a protectionist effort undertaken by the Province of Ontario in response to a lobby by the Brewers of Ontario.[405]

Stroh's position was developed in the following passage from the petition:

> The changes are not costs for services, but disguised non-tariff barriers designed to discriminate against United States imports. Furthermore, the changes were

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[402] Scotia McLeod (1990 p. 13)

[403] Inside US Trade. (31 July 1989).

[404] As a trade consultant to the BAC advised (BAC memo. 24 July 1989): "The Stroh submission focuses primarily on (but is not limited to) the Ontario July 10 pricing changes. While other problems are referred to (e.g. the BW [Brewers Warehousing] system) it is clear that the recent Ontario action has caused Stroh considerable concern, due, it would appear to the almost simultaneous cancellation of a large order from LCBO. The timing of the LCBO deferral in a *de facto* sense is unfortunate. However, the volume of the orders deferred and total orders was very large in the context of previous orders and previous US sales in Ontario. The orders were confirmed July 4 and cancelled July 5. This is clearly why Stroh is upset."

[405] As Stroh's attorney's Baker and McKenzie noted in their letter accompanying the draft Section 301 petition, (Stroh Draft Section 301 submission. 24 July 1989 p. 13): "The July 10 change in beer pricing arose, in large part, from a submission by the Brewers of Ontario, a trade association of Canadian brewers, to Mr. Nixon requesting pricing changes."

> designed solely to protect the domestic industry and merely to raise the floor prices of imports. These actions of the Ontario Treasurer are violative of the General Agreement on Tariffs and Trade and the United States-Canada Free Trade Agreement.[406]

Stroh was pushing on an open door when it brought its draft petition to the USTR in the summer of 1989. The USTR had been monitoring the conduct of provincial liquor boards closely since the CUSTA and the EC Panel Report. The agency's ongoing concern was articulated in its 1989 publication of the National Trade Estimate Report on Foreign Barriers (NTE) – which every year since 1985 cited the practices of Canadian provincial liquor boards as significant barriers to the entry of US beer exports.[407]

Moreover, there were a number of individual USTR officials who regarded the behaviour of Ontario in July as contemptible and clearly in violation of Canada's undertakings under both the CUSTA and the GATT.[408]

Lastly, St. Louis-based brewer Anheuser-Busch, the world's largest brewing company, was lurking in the background and pressuring the USTR to act. As one former USTR official interviewed for this dissertation explained:

> "It wasn't really Stroh and Heileman that were pushing the dispute in a way that would have forced USTR to act. Anheuser-Busch was behind the scenes and pushing harder than anyone else. The US government wouldn't go to bat to this extreme on behalf of just one company in a major industry. You've got to remember that USTR is a small place – and we have to pick our issues very carefully.[409]

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[406] Stroh draft Section 301 submission. (24 July 1989 p. 18)

[407] The USTR describes the NTE (USTR News Release. 28 April 1989) as: "an inventory of significant trade barriers imposed by major US trading partners. The report lists barriers that are both consistent and inconsistent with international trade rules, estimates to the extent feasible the economic impact of the barriers, and describes Administration action being taken to eliminate them. The NTE is one of the main resources that will be used by the USTR in evaluating priority practices and countries for designation under 'Super' and 'Special' 301 provisions of the 1988 Trade Act." The 1989 report specifically cited the practices of Canadian liquor boards in the following passage: "US beer, wine and distilled spirits suppliers have difficulty marketing their products since provincial liquor boards often refuse to 'list' (carry) their products or will only list a new product as a replacement for a previous US listing. If listed, boards charge discriminatory markups to discourage purchase of imported products and offer very limited distribution access.... As of February 1989 some provinces had not modified their policies concerning markups, listing and distribution practices to comply with the Free Trade Agreement provisions on alcoholic beverages. If provincial compliance is not forthcoming, the United States will take appropriate action."

[408] Dissertation interview.

[409] Dissertation interview.

With the ground thus prepared, it was not difficult for Stroh to pique USTR's interest in launching a case against Canada on provincial liquor board practices.

However, Stroh soon learned that Heileman had also been working on a draft 301 petition and was in fact much further along in the filing process with the USTR. Consequently, Stroh decided to hold its complaint in abeyance and allow the USTR to focus its efforts on responding to a single petition.

On 14 May 1989, Heileman filed a Section 301 Petition with USTR. Foreshadowing the politics that were to follow, Heileman chose Ottawa on 16 May 1989 to hold a news conference to announce its trade action

The principal thrusts of Heileman's Section 301 Petition were that: Canadian provincial liquor board mark-ups are excessive in absolute dollar amounts, and in many jurisdictions discriminatory against US beer imports; that US beer does not have fair and reasonable access to the dominant beer distribution outlets in many provinces, specifically in the Ontario Brewers Retail (BRI) system, the grocery store outlets in Quebec, the LRS stores in British Columbia and the hotel-operated 'Cold Beer Stores' in the Prairies; that provincial liquor board listing practices discriminate against US beer imports; and lastly, that these practices, along with others contained in the 866-page petition, violate Canada's obligations under both the GATT and the CUSTA.[410]

Heileman's selection of Ottawa portrayed a keen understanding of how the politics of the dispute were likely to unfold.[411] Heileman recognized that the successful CUSTA intervention by Canada's beer industry relied on a slender premise. That is, that Canada's brewers could be successful in marshalling both political and public support enough to influence policymakers in Ottawa to fend off an incursion by Washington.

Heileman was clearly betting that this support had diminished since the CUSTA had been signed, and that the Canadian federal government was no longer as apprehensive about the ability of Canada's brewers to disrupt its agenda. Additionally, Heileman reckoned that, if its arguments were presented properly to the right constituencies in Canada – i.e. Canadian beer drinkers thirsting for cheap product, 'free traders' within government, and their 'fellow travelers' in some of the more conservative media outlets, both of whom were arguing for the need to wean uncompetitive Canadian industries from artificial supports – it might be able to paint its effort as in Canada's national interest.[412]

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[410] BAC memo. (16 May 1989).

[411] The Financial Post reported on (15 May 1990) that: "Heileman will announce its complaint in Ottawa to tweak Canadian officials who the company feels have been dragging their feet on the GATT ruling."

[412] This view meshed closely with the perspective of USTR officials. As one USTR representative noted in an interview for this dissertation (Dissertation interview): "We recognized that Labatt and Molson were politically effective. However, we also knew that Canadian consumers might not be as supportive and that this could have an enormous impact on the views of government."

In addition to launching its Section 301 petition in Ottawa, Heileman hired a top Canadian government affairs/public relations firm - Executive Consultants Limited (ECL) - to manage its campaign with both the media and legislators in Canada. In an interview with an influential Ottawa publication targeted at the lobbying industry, Steve Markey, a partner with ECL, indicated that his company:

> ...[W]ill be assisting Heileman to conduct a major advocacy campaign in Canada, targeted not only at federal and provincial politicians and officials, but that the American brewer will also be taking its case directly to the Canadian public. Says Markey, 'on a hot summer day we'll be reminding Canadians that they will be paying twice as much for a case of Lone Star beer as they did last year, and that this is a consequence of our beer laws.'[413]

Heileman's news conference attracted the attention of most of Canada's national media. All of the major Canadian television broadcast outlets, including CTV, CBC and Global, as well as most national print media – including the Globe and Mail, the Toronto Star and the Financial Post – covered the Heileman event. Moreover, Heileman's key messages focusing on fairness and Canadians overpaying for beer were sympathetically reported.

With the filing of Heileman's petition, the clock was now ticking on whether Washington would choose to enter a formal dispute resolution process with Canada on beer. Section 301 stipulated that the USTR had 45 days to consider the petition (until 29 June 1990) and determine whether and when to launch an investigation. As Heileman was alleging that Canadian provincial liquor board practices violated Canada's commitments under existing trade agreements (GATT and CUSTA), the USTR was further directed by Section 301 to, within a maximum of 18 months from the date of initiation of the investigation, determine whether US rights were being denied and, if so, settle on what action to take.

Canada's Brewers Gird for Battle

To answer Heileman's complaint, Canada's brewers engaged in an intensive lobbying and public relations effort targeted at Canadian federal and provincial politicians and bureaucratic officials and Canadian media, as well as US politicians, bureaucratic officials and media. In going about this effort, the brewers recognized that they were vulnerable to Heileman's arguments about Canada's major brewers – and their 'co-conspirators,' the provincial liquor boards - gouging consumers.

Canada's brewers were also aware that with a series of other trade settlement disputes being launched by Washington – most importantly, softwood lumber – that the promise of the 'special' relationship between Canada and the US that was to have been delivered by the CUSTA could be ringing hollow to growing numbers of Canadians.

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[413] The Lobby Monitor. (25 May 1990).

Spotting an opportunity, the BAC undertook a classic campaign of 'misdirection.' It attempted to shift the focus of the dispute away from the substance of Heileman's complaint about the protectionist practices of provincial liquor boards, and on to the lack of efficacy of the CUSTA in sheltering Canadians from the wrath of US protectionism.[414]

Canada's brewers also lobbied Washington directly to impress upon US political and bureaucratic decision-makers that aggressive pursuit of the Heileman complaint could jeopardize its negotiations on NAFTA (North American Free Trade Agreement) - the follow-on agreement to the CUSTA, which was to include Canada, the US and Mexico.

Should Washington insist on pursuing the Heileman challenge, Canada's brewers took the position with both the US government and Canada's federal and provincial governments that it ought to be managed under the dispute settlement mechanism created by the CUSTA.[415] The BAC felt that if the dispute were to be handled under the CUSTA, the transition that Canada's brewers could expect to secure would be at least as much as the ten years granted spirits and wine under the agreement. If this happened, Heileman would likely be out of business by the time transition was completed.

In terms of public messaging, the BAC aimed to characterize Heileman's petition as a desperate move by a single US brewer in severe financial difficulty.[416] Canada's brewers also tried to sell the view that foreign brewers and Canadian beer drinkers were benefiting from several significant, positive changes in the Canadian regulatory regime for beer since CUSTA and the EC Panel Report.

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[414] Washington-based trade consultants to the BAC authored much of this advice. For example, a memo on May 15th from US trade consultants (BAC memo. 15 May 1990) recommended that: "It would appear to be in our interest to portray this dispute as more than just a simple trade complaint brought by a lone US brewer, but rather as an outbreak of a major trade war which threatens the viability of the Canada-US Trade Agreement. We should make it abundantly clear from the outset that the Canadian brewing industry (and hopefully the Canadian government) is prepared to fight this complaint to the bitter end. Such a clear signal early on will let Heileman know that this will be an expensive campaign (which they can presumably ill-afford) and senior officials in Washington that this dispute could significantly sour the US-Canada bilateral relationship in the post-FTA period."

[415] An BAC memorandum (BAC memo. 5 June 1990) summarized the line of argument that Canada's brewers would attempt with Washington on this point: "We could try to convince USTR (as well as officials at the State Department and the White House) to channel the Section 301 complaint into dispute settlement under the FTA. We could argue that one of the fundamental aims of the FTA is to provide a workable forum for resolving trade disputes between the two nations, and that diverting such disputes into other forums would render the FTA meaningless.

[416] The BAC set out the following characterization in a letter to Minister Crosbie: (Letter from Sandy Morrison to Hon. John Crosbie, Canadian Minister of International Trade, 16 May 1990): "As for the reason Heileman might be taking action at this time, there has been considerable discussion in the media on the financial condition of Heileman. Industry analyst Tom Pirko, President of BevMark Inc. consultants of Los Angeles, was quoted in the Wall Street Journal as saying, "They've (Heileman) got less than a year. There is no practical way they can continue on.' Furthermore, one of the leading trade publications, Beer Marketer's Insights, quotes documents from Bond Corporation, Heileman's

In a news release on 17 May 1990, the BAC identified a number of post-CUSTA and EC Panel Report changes to provincial liquor board practices, including: Wider brand choice for consumers - for example, imported beer listings improved 21 percent, with the number increasing to 100 from 69 in BC and from 33 to 40 in Ontario; sales of imported six-packs of beer in Canada increased 89 percent to 39.9 million, with an increase in Ontario alone of 329 percent to 20.9 million six-packs; new categories of markets have opened for imports – for example, imported draught beers, not marketed previously in British Columbia , were now available in the province; the Alberta markup system has been revised to eliminate the differential between domestic and imported beers; and lastly, Ontario has introduced a new 'fee-for-service' system to ensure that domestic and imported beers are charged on a equivalent basis for services provided through the liquor board retail system; and an independent audit has verified the fairness of the pricing structure.[417]

Although Canada's brewers were aggressively setting their campaign into motion to respond to the Heileman petition, they remained worried that the largest hurdle that they would face was the reluctance of Canada's federal government to defend them with vigour. This point will be explored in detail in Chapter 7.

Analysis:

The initial phases of the Section 301 process are readily explained by employing the statist hypothesis. Again, as with the events outlined in Chapter 5, most of what occurred can be attributed to rational calculations about the material interests at stake.

For example, that the USTR would seek to press the dispute on Heileman's behalf could have been the result of the intense lobbying that it was exposed to by a number of brewers – particularly Anheuser-Busch.

Additionally, Canada's role can also be explained by positing a rational calculation of utility. As noted in Chapter 5, the brewing sector is tiny in comparison to a number of other industrial sectors in Canada that could be affected negatively by a dispute with the US. Consequently, Canada's federal trade officials pressed the provinces to conduct audits to explain their cost of service regimes, but did little else to either aggravate or ameliorate the issue.

Australian parent, as stating that the brewer had a net loss of $126.7 million on sales of $796.4 million. The same trade publication reported the company had suffered a serious loss of market share in the United States, having dropped 1.4 million barrels during the past year."

[417] BAC news release. (16 May 1990).

However, there are hints in Chapter 6 suggesting that there may have been much more bubbling under the surface than a calculation of material interests can illuminate.

It is important to recall that US officials were not simply responding to the requests of their domestic brewers in weighing options on how to answer the Heileman complaint. Many USTR staffers had already formed opinions about the protectionist nature of Canada's provincial liquor boards.

These officials had been exposed to a number of US industry interventions about provincial liquor board practices over the years – for example, the California Wine Institute draft Section 301 petition – and they had also come to know the various provincial regulatory regimes because of the CUSTA negotiations and the EC Panel process. As one USTR official interviewed for this dissertation noted:

> Once I started to become exposed to the Canadian system for regulating alcoholic beverages, I was surprised that it had been allowed to exist for as long as it had. The system struck me as one that was designed to maintain barriers to foreign competition. It was uncompetitive – and it was inefficient for consumers. The parallel that I'd draw is what you might find in a Soviet economy, vintage 1950s or 1960s.[418]

Moreover, US officials were growing restless about the lack of Canadian action to implement the EC Panel Report. Canada had clearly been delaying since the SOI was first entered into in 1979. The time had come for real change to happen.

A final point to note is that USTR officials were becoming familiar with the attitudes of Canadian federal trade negotiators about the protected nature of Canada's beer industry. This 'cross-pollination' of views was facilitated by the numerous contacts officials had with each other through the CUSTA talks, the EC dispute settlement process and many other occasions either where trade negotiations occurred, or where negotiators interacted on a less formal basis (i.e. professional development, ceremonial occasions, or socially). After all, trade negotiators tend to have more in common with each other than they do with even their fellow citizens.

This latter point is more fully explained by comparing trade negotiators to politicians. As anyone with experience in government understands, the warp and woof of daily politics often creates strange bedfellows. For example, it is not unusual in Washington to find that certain Republicans have closer relations with friends in the Democratic Party than they do with members of their own party, and *vice versa*. In addition, in Ottawa, there are many Conservative Party members who enjoy much more cordial and respectful relations with Liberal and New Democrat colleagues than they would ever admit publicly.

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[418] Dissertation interview.

This is because elected politicians from rival parties tend to compete far less with each other (the real competition tends to be within their own party), spend a great deal of time together doing committee work, and are virtually all away from home attending legislative sessions in Washington or Ottawa. Moreover, they share common experiences and face very similar challenges – i.e. the need to both advance in their own party and to be re-elected. By virtue of these interactions and shared experiences, they have much more in common with each other than they do with 'civilians' outside of the process.

Relationships between Canadian federal government negotiators and their USTR counterparts can have a significant determinative impact on the course of trade negotiations.[419] As a USTR negotiator interviewed for this dissertation pointed out:

> The same people are involved in negotiations over the years – and over time you get to know your counterparts well. You tend to develop friendships with them and you find out what your common interests are. You get in a room with them and the view is 'we are all in this against our own domestic communities.' It is 'us against them.' And, as a government negotiator you are there to represent an industry for sure, but you also have to keep your eye on the bigger picture.[420]

A former Canadian trade negotiator echoed this view:

> You have relationships with your counterparts from other countries that are based on trust and respect. Often the view is 'what do you need to look good, and what do I need to look good? Let's shape it.' If anyone lies on what their real bottom lines are, then these people won't be effective. We would often go to lunch three or four at a time and arrange what we were going to do. This all has to happen on a personal level. We couldn't put it in a telegram back

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[419] It is important to note that these relationships are not always positive. One USTR official explained that Canada's relations with the US on trade are often strained, even on a personal level (Dissertation interview): "My view is that the least collegial relations we have are with Canada. When USTR staff sit with Canada we look at the world completely differently. Canada has a sense of self-righteousness that is distasteful. During the NAFTA talks, the Mexicans used to say to us all the time, 'How can you deal with the Canadians?"

[420] Dissertation interview.

> to Ottawa because back home they wouldn't understand.[421]

It was via these relationships that the views Canadian federal government negotiators held about the protected nature of the Canadian brewing industry and the need for change were 'diffused' to their USTR counterparts. The impact of these shared ideas will be explored in greater detail in Chapter 7.

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[421] Dissertation interview.

Chapter Seven

The Beer 1 Panel Process

Overview:

Chapter 7 reviews the period of the beer dispute spanning from Canada's initial response to the Heileman Section 301 petition to the findings of the Panel Report on the Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies, or Beer 1 as interested stakeholders would come to refer to it.

Highlights include the 'Crosbie letter,' correspondence by Canada's Minister of International Trade, Hon. John Crosbie, spelling out the Canadian federal government's views on how best to respond to mounting US pressure on provincial practices in the beer sector, the GATT Panel submissions of both Canada and the United States, the GATT Panel Report, and, lastly, the initial responses of both Canada and the United States to the Beer 1 Panel Report.

As in the preceding chapters, Chapter 7 will conclude with an analysis of the explanatory efficacy of the statist perspective as well as an assessment of the epistemic community approach to determine if it usefully augments a statist explanation of events.

The Crosbie Letter:

Canada's brewers had received a number of signals from their trade relations' consultants both in Washington and Ottawa that DFAIT negotiators were not inclined to mount a strong defence of provincial liquor board practices.

For example, a trade consultant to the BAC related a 7 May 1990 conversation with a senior DFAIT official on the case. He reported that the DFAIT official was of the view that:

> The Canadian government would very much like to eliminate most of the beer measures as being both 'bad public policy' and a constant source of undesired friction with the US. [422]

The same consultant reported in a memo three days later about another conversation with a DFAIT official involved in the beer dispute:

> I had a lengthy conversation this morning with XXXX [a senior Canadian trade bureaucrat]. XXXX and I get

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[422] BAC memo. (7 May 1990)

> along very well ... and he was clearly trying to warn me, in a friendly way, that Canada's federal government was not 'on side' in this matter.... [423]

The reluctance of Canada's federal government was soon confirmed by Canadian Trade Minister John Crosbie's response to a letter written by Sandy Morrison, President and CEO of the BAC.

Morrison's original dispatch to Minister Crosbie emphasized the need for Canada's federal government to answer any US incursion on provincial liquor board practices vigorously. It also implored Minister Crosbie to insist, in line with the brewers' strategy outlined in Chapter 6, that if the US sought a remedy to provincial practices, it must pursue it under the dispute settlement mechanism provided by the CUSTA.[424]

Minister Crosbie's response to Morrison, as well as some of his initial bilateral interactions with the US on the Heileman petition, alarmed Canada's brewers. [425] If there is a 'smoking gun' in the record demonstrating that Canada's federal government was not intending an aggressive defence of provincial liquor board practices, and also that it sought to distance the beer issue from CUSTA dispute settlement, it is in these responses by DFAIT to the initial US probes.

Prior to discussing the contents of Minister Crosbie's letter, it is important to note that while Ministers of the Crown in Canada generally do sign their own correspondence, it is not often that they actually write letters on policy matters themselves. In many instances, departmental staff do the drafting, and the Minister signs a final letter based on a cursory review and confidence in the staff's abilities.

Of course, the Minister has the prerogative to amend correspondence as she sees fit. However, on technical matters like trade policy, most correspondence reflects the department's view. The department controls the pen by virtue of its expertise on the policy area in question.

Given its similarity to views expressed by DFAIT staff at earlier junctures and in other fora, it is likely that Minister Crosbie's letter to the brewers reflected primarily the department's perspective. Afterall, this Minister's lack of interest in the details of specific trade issues had caused a national furor in Canada during the CUSTA debate when he claimed in the House of Commons that he had not read the entire text of an agreement that he had signed. It is not difficult to believe that he may have taken even less care on an issue that attracted little public interest and where his staff had a clear point of view.

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[423] BAC memo. (10 May 1990)

[424] Letter from Sandy Morrison to Hon. John Crosbie, Canadian Minister of International Trade (16 May 1990).

[425] A BAC memo (22 May 1990) comments on Minister Crosbie's public pronouncements: "Officials say that the comments made by Crosbie to the media reflect the discussions that took place within the meeting. In a conversation with Sandy Morrison, External Affairs XXXX said Crosbie told [USTR Carla] Hills that Canada recognized it was not in conformance with its GATT obligations and had admitted this by accepting the GATT panel report."

Minister Crosbie indicated in his letter that the US was going to accept the Heileman Section 301 petition, and there was not much that Ottawa could, or would, do about it.[426] The letter further pointed out that Washington was fully within its rights to circumvent CUSTA dispute resolution provisions and seek relief through the GATT.[427]

The letter also reminded the brewers that the GATT had already determined that provincial liquor board practices were inconsistent with Canada's trade obligations, and that the provinces had not done much to change this fact since the EC Panel Report.[428]

Lastly, consistent with Ottawa's position since the provincial liquor board disputes began, the letter proclaimed that the best defence against international trade actions – and specifically the Heileman section 301 petition - was for Canada to agree an IPB settlement in the alcoholic beverage sector. If Canada's brewers wanted to focus their lobbying energy on anything, the Minister recommended that it should be on pressing the provinces to move toward such an agreement with Ottawa.[429]

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[426] Minister Crosbie noted that (Letter from John Crosbie, Canadian Minister for International Trade to Sandy Morrison, President and CEO, BAC. 28 June 1990): "During the May 18 Canada-US Trade Commission meeting, we conveyed to the USTR, Ambassador Hills, Canadian concerns regarding the initiation of a Section 301 investigation on the basis of Heileman's position. We also restated our position that the issue of beer was addressed in the FTA and made a number of points you have raised. The US delegation, however, left no doubt that the petition would be accepted and a Section 301 investigation initiated within 45 days as required by statute unless new developments were to persuade the company to withdraw its petition. A Section 301 petition does not require industry support to be accepted. A single company can file a petition."

[427] Minister Crosbie indicated (Letter from John Crosbie, Canadian Minister for International Trade, to Sandy Morrison, President and CEO, BAC. 28 June 1990) that: "The FTA does not exempt Canada from its GATT obligations. The US is therefore within its rights to pursue this matter of provincial beer measures under the dispute settlement procedures of the GATT."

[428] Minister Crosbie pointed out that (Letter from John Crosbie, Canadian Minister for International Trade to Sandy Morrison, President and CEO, BAC. 28 June 1990): "While we will continue to defend our position that the provinces have met the FTA national treatment obligations on beer, we cannot ignore the fact that a GATT Panel has already found that provincial measures that discriminate against imports are inconsistent with our GATT obligations."

[429] Minister Crosbie suggested that (Letter from John Crosbie, Canadian Minister for International Trade to Sandy Morrison, President and CEO, BAC. 28 June 1990): "In the Canada-EC Liquor Boards Agreement, Canada began bringing our beer marketing practices into conformity with our GATT obligations by undertaking to provide national treatment insofar as listing practices were concerned. We also committed ourselves, in the context of that agreement, to bring our beer pricing practices into conformity with our GATT obligations, upon successful conclusion of the negotiations to make significant and demonstrable progress. The achievement of an interprovincial agreement would allow Canadian industry to adjust effectively to meet international competition and would enable us to retain the initiative in determining, with our trading partners, how and when we will meet our international obligations with respect to beer. It could also provide the basis upon which we could attempt to dissuade the US from taking GATT action. I would therefore ask that the Brewers

Minister Crosbie's letter was distressing to the industry, but not unexpected. Canada's brewers had assumed for some time, and the letter now confirmed, that DFAIT's agenda on provincial liquor board practices had at its core the leveraging of international trade disputes to force a reduction in IPBs. The letter also reified for the industry that Canada's federal government would seek to avoid testing the efficacy of CUSTA dispute settlement on the beer dispute.

Activation of CUSTA dispute settlement proceedings risked aligning the interests of Canada's brewers with those of a growing group of CUSTA critics. Should these two forces come together, a wave of condemnation could potentially be targeted at both the CUSTA, and the new trade priority for the Mulroney government, NAFTA. Consequently, debate would no longer be focused on the commercial practices of the liquor boards, where DFAIT officials reasoned they had a strong argument substantiated by the EC Panel Report. Instead, it would center on the failure of CUSTA to create the 'special relationship' between Canada and the US that had been promised by the Mulroney Tories. This was a prospect that DFAIT supporters of the CUSTA preferred not to risk.

Canada's brewers discovered that they had an even more troubling issue than Ottawa's lack of support. US trade officials had learned of DFAIT's reluctance to defend provincial liquor board practices.

US knowledge of Ottawa's disinclination to defend provincial liquor board practices was potentially significant in that lukewarm support by a foreign government for its own industry had in the past fuelled Washington's interest in pressing specific trade complaints. As one of the BAC's trade consultants advised:

> My experience is that Section 301 becomes a major problem for a foreign industry to the extent that the foreign government (which is usually more of a problem than the US government) believes that the foreign industry's position is wrong or that its industry lacks domestic political clout. This suggests a forceful communication by (provincial governments) to Canada's federal government to 'hold firm', as it finally did during the FTA.[430]

Canada's Brewers Reach Out to the Provinces

Canada's brewers followed their Washington lobbyist's advice. Sandy Morrison sent a letter to each of the Provincial Premiers on 16 May 1990 outlining the

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Association of Canada lend its support to the efforts currently being made by the federal-provincial panel to reach a successful conclusion in the negotiations on an interprovincial agreement."

[430] BAC memo. (7 May 1990)

industry's views on the Heileman petition and seeking each province's assistance to bring Ottawa on side.

Most of the responses that the brewers received to the May 16th letter were relatively non-committal. While many provinces saw the CUSTA as beneficial, they also recognized that the breweries in their jurisdiction – and the high paying employment and tax dollars that went along with having them – could be put at risk by unfettered access of cheap US imports into Canada. As a result, many provinces found themselves with one foot in the brewing industry's camp, and the other with Canada's federal government. For most provinces, it made sense to take a 'wait and see' approach.

Two notable exceptions were Ontario and Alberta. Their positions had been for the most part pre-determined by the CUSTA debate. For example, Ontario Premier David Peterson, whose government vehemently resisted CUSTA, was direct in stating that Canada's federal government must oppose the US entreaty on beer.[431]

Alberta, a strong proponent of the CUSTA, was much less enthusiastic about the dispute being adjudicated under that agreements dispute settlement provisions. Edmonton responded to Morrison's letter as follows:

> … Article 1205 of the FTA makes it clear that both Canada and the US retain their GATT rights and obligations on beer. In light of the GATT Panel Report on Alcoholic Beverages of February 1988, and the Heileman petition citing GATT rights on a number of practices, it is unlikely that the US will choose the FTA dispute settlement process.[432]

Recognizing that the odds were not in their favour, Canada's brewers sought to better their bargaining position by launching two trade actions against the US. The first was a dumping complaint against US brewers in Western Canada. The second was a GATT Panel complaint against US federal and state practices that discriminated against Canadian imports.[433]

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[431] Ontario Liberal Premier David Peterson's support for the brewers was specified in his reply to the brewers letter (Letter from Ontario Premier David Peterson to Sandy Morrison 25 July 1990): "I agree with your [the BAC's] assessment of the petition and the possible motivation of Heileman in filing such a petition at this time. Let me assure you of the support of the Ontario government in fighting this trade dispute. The Honourable Monte Kwinter has on several occasions conveyed to Mr. Crosbie Ontario's concern that the US must respect the grandfathering of existing beer practices in the Free Trade Agreement."

[432] Letter from Hon. Peter Elzinga, Alberta Minister of Economic Development and Trade to Sandy Morrison. (5 July 1990).

[433] Inside US Trade (8 February 1991) reported on Canada's filing of Beer II: "Canada this week formally challenged at the GATT what it claims is discriminatory US state and federal treatment that is unfair to foreign brewers. Specifically, Canada pointed to a federal excise tax on beer, wine and cider, passed as part of the budget reconciliation act of last year, that reduced tax treatment for small US producers, but not for their foreign competitors. In addition, Canada cited numerous state labeling

Canada's brewers initiated these actions to create leverage for the inevitable negotiations between Ottawa and Washington that would result from the Heileman petition.[434] However, it is important to note that while Canada prevailed in both complaints, neither proved to be of significant value in the negotiations with the US.[435] As indicated previously, if the US does not want to change its regulatory practices to answer a trade judgment, it has the ability to resist the demands of smaller trading nations. This is particularly the case for states that both covet the US market and do not necessarily support the complaint launched by their domestic industries.[436]

Canada Responds to the Heileman Petition

Section 301 procedures permit a foreign government to respond to a US petitioner's allegations. The BAC lobbied aggressively for Canada's federal government to file a stiff rebuttal to Heileman's petition. To help shape the effort, the brewers relied on their Ottawa and Washington-based trade consultants to draft the kind of document that they hoped Ottawa would submit. In addition, Canada's brewers urged Ottawa to pressure political and bureaucratic officials in Washington to persuade the USTR to reject the Heileman petition.

The result of this activity was that Ottawa did in fact file what the BAC judged to be an acceptable rebuttal.[437] Moreover, DFAIT sent senior officials to lobby their Washington counterparts to try to convince them to deny Heileman's petition. But, given the views that DFAIT officials held openly about both the Canadian brewing

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and distribution requirements that they claim also hinder foreign sales in the US." The US never regarded this challenge as a serious one. A BAC memo (16 February 1991) indicated that: "the reaction of American trade officials has been surprisingly muted. USTR staff view the Canadian complaint against discriminatory federal and state practices to be more of a nuisance than a real threat."

[434] A senior Canadian brewing company official interviewed for this dissertation noted that (Dissertation interview): "The GATT action against the US was strictly to secure a bargaining chip. While there was some financial up side if we won, it was negligible to my company. So, my view is that 90% of why we initiated Beer II was to get some leverage."

[435] Though, it should be noted that the successful dumping complaint in BC did provide Canadian brewers with significant financial relief in the BC market until it was reversed as one of the outcomes of the settlement that was eventually reached on Beer 1 with the US.

[436] Despite losing a GATT challenge to Canada, the US has resisted to this day changing virtually any state or federal preferences for its domestic producers.

[437] Canada's rebuttal document is described in a BAC memo (22 June 1990): "Canada does intend to lodge a response to the Petition next week. [DFAIT] officials were reviewing their draft today in the expectation it would be forwarded to Washington early next week. Canada intends to attack the inaccuracies in the Heileman petition and reiterate the view that it should be rejected out-of-hand. They also stated they will argue that the Section 301 procedures are inappropriate in this circumstance where there is a process underway [negotiations on the EC Panel Report] that will deal with the substantive issues raised in the complaint."

industry and the trade defensibility of provincial liquor board practices, it is doubtful that Canada's case was pressed with much vigour.[438]

Canada's attempts to slow US prosecution of the dispute were largely ineffective. On 29 June 1990, the USTR accepted Heileman's petition. The USTR also indicated that the US would make a formal request at the GATT in Geneva under Article XXIII to enter consultations with Canada on provincial liquor board practices on beer.[439]

While the brewers had expected the USTR to accept the Heileman complaint, they did not anticipate Minister Crosbie's tepid public response. In a DFAIT news release on 29 June 1990, the Minister answered the USTR acceptance of the Heileman petition:

> International Trade Minister John C. Crosbie today said he was disappointed by the US government's decision to proceed with an investigation of Canadian beer marketing practices, under Section 301 of the US Trade Act. 'In meetings with USTR Carla Hills, and in meetings between Canadian and US officials, we have attempted to explain the misconceptions and

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[438] These efforts are described by the BAC as follows (BAC memo, 22 June 1990): "… [T]he BAC submitted a draft response to the petition, prepared with the assistance of legal counsel and trade policy advisors in Ottawa and Washington…. Canada's Ambassador to Washington, Derek Burney, [also] met with the Deputy at USTR, Jules Katz, to argue that the petition should be rejected or withdrawn on the grounds that it was ill-prepared and inaccurate in content, and to the extent that it referenced the GATT Panel report of 1987 [sic], failed to recognize that Canada was engaged in a process agreed to by the EC that would result in Canada meeting its obligations as defined by the Panel Report. Katz stated that the Heileman petition did not have any strong support within the US administration or amongst Congress, but did have 'legal merit' and must be processed by the USTR. He added that in initiating consultations under the Section 301 process, the US did not envisage a serious confrontation with Canada and would be prepared to consider these other issues over the 150-day consultative period that follows from the June 29th acceptance date. It is the view of Burney and other officials at EAIT [External Affairs and International Trade] in Ottawa that there is no possibility of blocking the acceptance of the Heileman complaint."

[439] The GATT process would operate as follows (BAC memo. 29 June 1990): "Canada has a 10-day period to respond to the US request and 30 days in which to initiate consultations on the substance of the American complaint as represented by the Heileman petition. If a settlement to the dispute has not been reached within 60 days, the US would have the right to make a formal request for a Panel to be established to investigate the complaint. At the same time, if the parties agree that progress is being made, or alternatively if the GATT Council believes that the dispute can be resolved without a Panel through further negotiations, the consultative process can be extended beyond the 60 day period. If the US compressed the timetable to the maximum extent possible, they would be able to submit a request to the GATT Council for a Panel at its October meeting [which is in fact what the US did]. It is normal for these requests to be carried over for one month at the request of the respondent. External has already indicated that they would defer consideration of any Panel request raised in October. Therefore, the earliest that a Panel could be authorized would be November of this year. Action on this issue may be deferred by the pressure that will be on GATT as a result of the need to conclude MTN negotiations before the end of 1990 and the priority attached to these major negotiations. At the same time, the 150 day period for consultations will be running concurrently pointing to a decision date of November 1990, as is the case under the GATT reference."

> factual errors contained in the petition filed by the G. Heileman Brewing Company, alleging that Canadian beer regulations hampered the company's access to the Canadian beer market', Mr. Crosbie said. 'Unfortunately, the US government has decided to proceed with the investigation.' [440]

Given the remonstrations of the BAC's Washington-based trade consultants that the USTR could potentially be persuaded to tread cautiously on the Heileman complaint if Ottawa protested loudly enough, Minister Crosbie's response was very disappointing. While diplomacy requires that disagreements between close trading partners be characterized publicly more by sorrow than anger, the brewers had expected at least some fiery rhetoric from one of Canada's most gifted political orators.

However, more important than Minister Crosbie's indifferent public response was that Canada also acceded quietly to the USTR taking the dispute to the GATT as opposed to CUSTA. Consequently, the potential political linkage that the brewers may have hoped to make to the anti-CUSTA movement in Canada was dashed before it started. [441]

The Beer 1 Panel

As noted in Chapter 5, entering consultations with another party in the GATT dispute mediation process was largely a *pro forma* exercise virtually never ending in settlement being reached. The Canada-US beer dispute was no exception. Consultations between Washington and Ottawa quickly fizzled.

Moreover, the USTR attempted to expedite the dispute settlement process even more quickly than normal by suggesting that a new panel was not needed. In Washington's view, the EC Panel Report was explicit enough in its recommendations about the actions that provincial liquor boards had to take. The provinces had simply chosen to demur and delay. The US argued that sanctions were clearly required to compel the provincial liquor boards to comply with Canada's GATT obligations.[442]

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[440] DFAIT news release. (29 June 1990).

[441] BAC memo. (29 June 1990). The brewers were advised that a further reason that USTR may have elected for GATT dispute settlement was because of other trade issues that were simmering with Canada: "The decision of the US to push this issue into GATT at this time may have been prompted by Canada's actions in seeking retaliation on a sugar issue (an issue closely linked to beer in the Free Trade negotiations) and to Canada's refusal to accept the decision of a GATT Panel on ice cream and yogurt."

[442] A BAC memo (16 April 1990) outlines this issue: "I should advise that our contacts in Washington have supplied a report as of today from USTR sources … [that] … the USTR has held informal discussions in Geneva and it is by no means certain that the US would be required to initiate a new Panel investigation on the beer issue. It is now suggested that the GATT Council might well be persuaded to authorize retaliation by the Americans of the outstanding unresolved GATT Panel report."

The US pressed aggressively at the 3 October 1990 meeting of the GATT Council for satisfaction in its dispute with Canada. In its submission to GATT Council, Washington requested permission to retaliate against Canada to force compliance with the EC Panel Report:

> ... [Canada] continues to nullify or impair benefits accruing to the United States under the General Agreement. Efforts to resolve the matter through consultations have not been successful. Since the practices already have been found by the CONTRACTING PARTIES to be inconsistent with Canada's obligations under the General Agreement, the United States hereby asserts its rights under Article XXIII:2 with respect to the findings of the 1988 Liquor Boards panel report [EC Panel Report] and requests that the Council decide that the circumstances are serious enough to authorize the United States to suspend the application to Canada of appropriate concessions or other obligations.[443]

The USTR next stepped up its attack on Canada by working with Stroh to bring its Section 301 petition back to life. As noted in Chapter 6, the USTR had held back on the Stroh complaint expecting the Heileman petition to come forward. USTR officials were now looking for additional ways to keep the pressure building on Ottawa and the provinces.[444] They felt they could do this by bringing the Stroh and Heileman petitions together in a comprehensive package.[445]

The Province of Quebec strongly protested the USTR's efforts to pull both investigations into the same process. However, Quebec's argument only fanned the flames in Washington. Citing its own trade consultants, the BAC noted in a memo to its members that:

> There has been no doubt in USTR about folding the Stroh complaint into the Heileman investigation despite the legal objections raised by Quebec. In fact,

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[443] The text of the US submission is quoted in a BAC memo (24 October 1990).

[444] USTR news release 'United States to address Stroh's allegations in its efforts to enforce GATT rights on Canada's restrictions of beer imports.' (19 October 1990). The news release set out the USTR's rationale for binding the two disputes together: "Rather than initiate an additional Section 301 investigation on the allegations raised by Stroh's, Hills [USTR Carla Hills] will investigate these allegations in the course of the ongoing [Heileman] investigation. This decision is designed to avoid confusion and delay in the Section 301 process, and does not represent any diminution of the efforts of the United States to pursue its rights under the GATT against Canada."

[445] A BAC memo (22 October 1990) indicated that launching the Stroh dispute was part of a comprehensive strategy planned by the USTR. "According to XXXX [USTR official], this scenario of a second 301 petition was pre-cooked earlier this year when Stroh visited USTR regarding their concerns with Ontario."

> Jane [Bradley] is upset that someone (Quebec) is challenging her on the 301 procedures which she claims were written by her.[446]

To aid their cause with the USTR, Stroh and Heileman lobbied aggressively in Washington to engage political interest in the dispute. This lobbying at the political level was a departure for both companies.[447] To this point in the dispute, both Stroh and Heileman had focused their attention almost exclusively on the USTR. But, with the USTR having taken up their cause, Stroh and Heileman believed that political support could help the agency to stay the course, and deflect the pressure of other, often bigger, sectors lobbying for USTR resources to be expended on their issues.[448]

Moreover, as noted previously, Stroh and Heileman were not acting alone. Anheuser-Busch was also using its political influence to ensure that the USTR continued to press the case against Canada.[449]

The political work of Stroh, Heileman and Anheuser-Busch began to bear fruit. Carl Levin, Senator from Michigan – the home of Stroh - and five other Senators wrote USTR Carla Hills on 23 October 1991 asking that action be taken against Canada.[450] In addition, Wisconsin Senator Robert W. Kasten – from Heileman's home state, a co-signatory to the Levin letter, published a news release linking the Canadian beer barriers to 'lost American jobs.'[451]

An additional dynamic affecting events was a growing animosity at USTR about the behaviour of the provincial liquor boards. As USTR officials learned more about the trade restrictive practices of provincial liquor boards, they became convinced not only that the US had a good case under international trade law, but that the attitudes and practices of the provincial liquor boards were egregious. Interestingly, this was a view that they shared with their DFAIT counterparts.[452]

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[446] BAC memo. (22 October 1990).

[447] The BAC's trade consultants had been advising that Heileman and Stroh were focused almost exclusively on the USTR. A BAC memo (14 November 1991) noted that: "It appears that the push for 301 in the absence of total capitulation is driven primarily by USTR. Our sources in the House Ways and Means Committee have not detected any profile on this issue. There is no guarantee that US decisions on how to treat Beer 1 will be based on facts. The US officials handling the file smell blood and consider they are justified."

[448] As one of the BAC's Washington-based trade consultants indicated (BAC memo. 2 April 1991): "Until recently, there was little or no evidence of outside political pressure on USTR to take action on Canadian beer practices – if anything, the pressure seemed to come from inside the USTR. Consequently, there were good arguments to be made for keeping a low profile on Capitol Hill, both because of the relative absence of activity (since Congressional staff would automatically side with the US industry in the absence of any countervailing reason.) Both aspects are now changed. The search for co-sponsors has generated interest in a number of congressional offices and made beer into an issue on the Hill."

[449] A USTR official interviewed for this dissertation noted (Dissertation interview): "The main players were Stroh, Heileman and Anheuser Busch. If it had just been Stroh and Heileman, the USTR would have been less willing to pursue Canada aggressively. Anheuser Busch was the most vocal and the one pushing the dispute the hardest."

[450] Letter from Senator Carl Levin to USTR Carla Hills (23 October 1991).

[451] US Senator Robert W. Kasten news release: 'Kasten wants more beer exports to Canada' (13 November 1991).

Consequently, officials at USTR began to see the beer dispute in less clinical terms than many of the other disputes they handled. As a former USTR official interviewed for this dissertation noted:

> There were certainly some principles involved at USTR with the beer dispute. It was a longstanding issue that took some time to resolve. And, oftentimes, it became personal. At bottom, there were people that cared about this case personally at USTR.[453]

Linkage to the EC Panel

With momentum building against the provincial liquor boards, potential relief came from an unlikely source – Canada's DFAIT officials charged with managing negotiations on the original EC dispute. Canada's EC Panel negotiating team proposed an alternative route to manage the Heileman complaint that did not involve engaging the US in an unnecessarily provocative bilateral showdown. They buttressed their viewpoint by intimating that they had conducted informal discussions with the USTR's office, and the officials they had contacted seemed supportive.[454]

It is important to recall that despite the agreement between Canada and the EC to resolve the 1988 Panel, many outstanding issues remained on beer practices. Moreover, a significant concern continued unabated in Ottawa about the need to dismantle interprovincial barriers to trade. Canada's EC Panel negotiating team's initiative was designed to move toward resolution of both issues – and, at the same time, provide the US with enough satisfaction on provincial liquor board practices that it could accept half a loaf on the Heileman complaint.

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[452] While they shared a commitment with DFAIT on the importance of free trade, this does not mean that USTR officials were particularly supportive of Canadian actions and attitudes on trade generally. As one senior USTR official interviewed for this dissertation noted (Dissertation interview): "For the USTR, there is no country regarded with greater enmity than Canada. The worst file that you could get at USTR was one involving a dispute with Canada. Any trade policy issue with Canada was always ugly, always contentious."

[453] Dissertation interview.

[454] A BAC memo (16 April 1990) reported that: "…[I]t was XXXX [senior DFAIT official's] view from his conversations with XXXX of the USTR, that the US would not be adverse to rejecting the Heileman petition if there was any reasonable basis for doing so; a basis that might be provided by a timely settlement of the outstanding GATT Panel dispute." Another BAC memo (BAC memo 19 June 1990) reported on a meeting between Canadian Ambassador to the US Derek Burney and Deputy USTR Julius Katz (BAC internal memo 19 June 1990) where: "… Katz made it clear that USTR didn't really want any part of the [Heileman] case, and particularly didn't want to adversely affect the bilateral relationship."

In a conversation with the BAC's Sandy Morrison,[455] a senior DFAIT official connected with the EC Panel negotiations pointed out that Canada had resolved all issues surrounding spirits and wine in the EC Panel Report. Transition periods negotiated with the EC ranged from immediate (in the case of spirits markups) to 7-10 years for wine. The DFAIT official also reminded Morrison that Canada had assented to deal with non-conforming beer practices eventually, but had also obtained a standstill agreement with the EC pending the outcome of negotiations between Canada's federal and provincial governments on IPBs.

The DFAIT official further advised that although the EC remained patient over the delays on IPBs, should the US seek GATT action on beer based on the EC Panel Report, or if Canadian federal-provincial negotiations then underway on the removal of internal trade barriers collapsed, the EC would demand action on the outstanding GATT Panel decision.

With this as backdrop, the DFAIT official suggested that an opportunity might exist for Canada to utilize the outstanding EC Panel, and a predilection by the Europeans to finalize its disposition, to effectively block any move by Washington to utilize GATT to skirt US obligations under the CUSTA.

The DFAIT official intimated that the EC could well respond positively to a proposal by Canada to establish a firm timetable for the elimination of IPBs (for example, by 1995), to be followed by a further five year phase out of existing non-tariff barriers to the sale of imported beer in Canada. Importantly, it was the DFAIT official's view that the issues to be dealt with in such an EC negotiation would be considerably less demanding than any process involving the US.

The DFAIT official also recommended that it might be unnecessary to open Canadian brewery-owned distribution systems, particularly in Ontario, and the depanneur (grocery store) system in Quebec, to settle the EC Panel dispute. Moreover, unlike the US, the EC had not challenged the changes introduced by Ontario to its mark-up, cost-of-service and base price systems in the summer of 1989.

If negotiations with the EC were successful, the DFAIT official suggested that the US would be effectively 'locked in' to the timetable and transition arrangement agreed to in the EC settlement, at least insofar as the GATT was concerned. Thus, the US would be forced back into the CUSTA framework where Canada was required only to demonstrate that any changes to provincial liquor board systems since the CUSTA did not further impair the access of US brewers to the Canadian marketplace.

Canada's brewers were elated at the DFAIT official's proposal. It appeared to offer a way out of the impending imbroglio with the US – and at a price to the industry that could be endured. Sandy Morrison contacted various company members of the BAC on 22 May 1990 to share the news and secure a mandate to signal support.

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[455] BAC memo (16 April 1990).

Three factors are curious about the DFAIT official's strategy. First, on its face it seems implausible. To believe that the USTR would sit by and allow Canada to thwart the interests of US brewers by virtue of a wrinkle in GATT procedure does not seem consistent with a growing aggressiveness in Washington about opening up foreign markets to US goods. Second, mounting animosity at USTR about the behaviour of provincial liquor boards, and Ottawa's inability to bring them into compliance with Canada's international trade obligations, also suggests that the US was not about to have its efforts denied by Canadian maneuvering at the GATT. Lastly, to suggest that CUSTA dispute settlement might be the best forum to resolve US issues over Canada's beer practices is clearly at odds with the position taken by Minister Crosbie in his letter to the BAC. Either the DFAIT official was unaware of Minister Crosbie's views, or the DFAIT official deliberately chose to thwart them, or the DFAIT official had another strategy in mind.

The most plausible explanation is that the DFAIT official was working to execute an alternative strategy. The DFAIT official's line of attack focused on garnering brewer and provincial support for eliminating IPBs, without really risking anything on the CUSTA front. The DFAIT official surely understood that the US was not about to accept being locked into a cosmetic solution at GATT, and that the EC would not allow a settlement of its case to be used to block potentially even greater benefits to its domestic industry that could accrue from a successful US Panel. Moreover, the DFAIT official knew that Ottawa would not permit the beer issue to be referenced to CUSTA dispute settlement. In short, the DFAIT official was looking to make short term progress on IPBs knowing that over the long haul any promises that were made about the GATT or CUSTA would likely be thwarted by the actions of others.

Whatever the explanation, the DFAIT official's proposal was soon rendered irrelevant by events. Despite Canada going so far as to sign an additional side-letter with the EC to settle outstanding questions on listings,[456] the US was not as amenable to Canada's suggestions as the DFAIT official had intimated.

The BAC's Washington-based trade consultants reported that the DFAIT official's proposal was vetted with the US in a meeting between senior trade officials in October 1990. The consultants reported that:

> "Carla Hills [the USTR] indicated she did not want to be faced with a take it or leave it situation when Canada has completed its discussions with the EC."[457]

With that, the Wilson proposal was dead.

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[456] A side-letter between EC Ambassador Avery and Canada was exchanged on 22 October 1990.

[457] BAC memo. (15 October 1990)

The US Panel is Convened

It will be recalled that the US requested permission to retaliate against Canada at the 3 October 1990 meeting of GATT Council. GATT tradition established that a country that is complained against is given one meeting of the Council to respond.

Consequently, the US was obliged to raise the issue of Canadian provincial liquor board practices again at the next GATT Council on 12 December 1990. This time, in addition to seeking permission to retaliate based on the 1988 EC Panel, the US requested a new Panel in the event that GATT Council did not support a withdrawal of concessions.

The US representative to GATT Council made the following statement in support of the US submission:

> Mr. Chairman, this item was discussed at the last Council, so I will be brief. We have seen no indication that Canada will take meaningful steps in the foreseeable future to modify the practices found by the 1988 Liquor Boards panel to be inconsistent with Canada's obligations under the General Agreement in order to bring them into GATT compliance. Indeed, not only has Canada failed to bring into compliance the practices identified in the 1988 Liquor Boards panel report, but some provincial liquor boards have instituted new practices since the adoption of the 1988 report that are inconsistent with Canada's obligations under the General Agreement. Repeated requests to Canada for Council affirmance [sic] of our rights with respect to the 1988 Liquor Boards panel report have been rejected; Canada has implemented new restrictive practices since 1988; and a satisfactory adjustment to the matter through consultations in July 1990 has not been possible.[458]

GATT Council acceded to the US request for a Panel.[459] To ensure that the process moved along expeditiously, GATT Council reconvened the same panelists – from Argentina, Switzerland and Israel - that heard the 1988 EC Panel.

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[458] US Statement to GATT Council on a request for a Panel to investigate Canadian provincial liquor practices. (12 December 1990).

[459] The process for the Panel was as follows (Memo from EF Haran, Panel Chairman, to D. George, First Secretary Permanent Mission of Canada. 21 June 1991):

- 15 July 1991 – receipt of comments by the two Parties on draft descriptive part of the report, and of the Canadian response on the cost of service audits.
- 29-30 July 1991 – meeting of the Panel, beginning with a meeting of the Parties.
- 9 August 1991 – submission of descriptive part of the report.

That the dispute was to be heard by the same panelists did not seem to be an issue for Canada. In fact, there was a belief amongst the trade consultants advising the BAC that these panelists had actually shown sympathy for key elements of the Canadian case in the EC dispute. The new Panel could clarify to Canada's benefit some of the issues that had been left unanswered by the 1988 Panel

The US representatives also had a positive view of the same Panel being reconvened – though for a different reason. As a USTR official noted in an interview conducted for this dissertation:

> Getting the same panelists was our most important achievement in the case. Canada had some legitimate arguments, but they had been made to these panelists once before. The deal was sealed once we got the same panel. [460]

As later events would show, the US view was the more prescient one.

The US continued to press for a quick resolution of the dispute. Christopher Parlin, a legal advisor to the USTR, wrote EF Haran, the Panel Chair, on 5 March 1991, to call for an expedited Panel process. He requested that the Panel structure its work to first, determine whether Canada remained in breech of the 1988 EC Panel Report, and second, to assess new allegations brought by the US about provincial liquor board practices that were not considered by the EC Panel.[461]

The Panel did not accede to the US request for an immediate determination on Canada's position relative to the 1988 EC Panel. It opted instead to rule on this issue after it heard all the arguments from both parties. The Panel chose to proceed as it would in a regular investigation – though it did take note of the US request that the matter be dealt with on an urgent basis.[462]

- 23 August 1991 – receipt of comments on descriptive part of the report.
- 18 September 1991 – submission of final report to the Parties.
- 16 October 1991 – circulation of report to the contracting parties.

[460] Dissertation interview.

[461] Letter from Christopher Parlin, USTR Legal Counsel to EF Haran, Panel Chair. (5 March 1991).

[462] In a later submission to the Panel (Second submission of the Government of the US to the Panel examining the import, distribution and sale of certain alcoholic drinks by Canadian provincial marketing agencies – 7 May 1991) the US expanded on its argument as to why an expedited judgment was required: "In this dispute, the US claims the rights that accrue to the complainants to a dispute – to have a panel review the evidence and issue findings and recommendations concerning the rights and obligations under the General Agreement of the parties to the dispute. But the circumstances underlying the dispute are without precedent. Never before in GATT experience has a contracting party been compelled to invoke Article XXIII:2 in order to 'enforce' the recommendations of the Contracting Parties in a previous GATT panel report that have remained unsatisfied by another contracting party for more than three years. In addition, in light of market conditions in the Canadian beer market, US brewers could incur irreparable damage as a result of lost sales during the critical summer season if findings are not issued on an expedited basis."

The US presented its first submission to the Panel on 19 March 1991.[463] It argued in this submission, and in subsequent written and oral presentations to the Panel, that provincial liquor boards maintained listing practices that discriminated against imported beer, discriminatory price mark-up practices, and restrictions on points of sale.[464]

The US also maintained that Canada permitted discriminatory and restrictive practices not specifically addressed in the 1988 panel report, but that were in existence before 1988, to continue in force. In addition, Canada had allowed new restrictive practices to be instituted. As evidence, the US cited provincial restrictions on private distribution, discriminatory assessment of 'cost-of-service' differentials, discriminatory establishment of retail beer prices, discriminatory assessment of environmental taxes, additional mark-ups on draft beer, and failure to publish new practices.

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[463] Specifically, the US requested that the Panel find that (Draft Panel report, Canada-Import, Distribution and Sale of certain alcoholic drinks by Provincial marketing agencies. 24 June 1991):

- Restrictions on private delivery were inconsistent with the provisions of Articles III:4 and XVII of the General Agreement.
- Restrictions on access by imported beer to points of sale constituted restrictions made effective through state-trading operations contrary to Article XI:1 of the General Agreement; with respect to mark-ups:
  - The application of differential mark-ups on all beer in New Brunswick, Nova Scotia, Ontario and Quebec, and on imported draft beer in British Columbia;
  - The methodologies used in calculating cost-of-service differentials in Alberta, British Columbia, Manitoba, Nova Scotia, Ontario, Quebec and Saskatchewan;
  - The overall methodology of price calculation in Alberta, British Columbia, Nova Scotia, Ontario, Quebec and Saskatchewan.
- The following elements of the methodology of price calculation were inconsistent with the provisions of Article II:2 of the General Agreement:
  - The application of an ad valorem basis of cost-of-service differentials;
  - The application, in Alberta, British Columbia, Nova Scotia, and Quebec of the cost-of-service differential before the mark-up;
  - The application, in British Columbia and Saskatchewan, of a second-stage cost-of-service differential after the mark-up;
  - The application in British Columbia, Nova Scotia, and Ontario of ad valorem provincial and federal taxes at the end of the price calculation.
- The minimum price requirements in British Columbia and Ontario constituted restrictions made effective through state-trading operations contrary to Articles XI:1 and XVII of the General Agreement; and that, to the extent that they discriminated against US beer in particular, they were inconsistent with the provisions of Article XIII of the General Agreement;
- The taxes levied on beer containers in Manitoba, Nova Scotia and Ontario were inconsistent with the provisions of Articles III:4 and XVII of the General Agreement;
- In British Columbia and Ontario, the notification procedures for new liquor board practices were inconsistent with the provisions of Article X of the General Agreement; and
- As a result of the practices complained about, US rights under the General Agreement were being nullified and impaired.

[464] First submission of the US Government to the Panel examining import, distribution and sale of certain alcoholic drinks by Canadian provincial marketing agencies. (19 March 1991).

It is important to note that many of the rules and regulations the US challenged were instituted by provincial liquor boards in answer to what provincial officials felt was the direction of the 1988 Panel. For example, on cost-of-service, many provincial liquor boards conducted audits that they believed adhered to the standards prescribed by the Panel. The US was now charging that, by instituting these new standards and practices, the liquor boards were simply replacing one set of discriminatory provisions with another.[465]

The US submission exploded a further misperception under which provincial liquor boards had been labouring as they tried to bring their practices into compliance. For the better part of a decade, Canada had argued to its trading partners that special account needed to be taken of the Canadian industry's structural disadvantages caused by IPBs. For the industry to adjust it was necessary to first dismantle trade barriers between the provinces, and then impediments to foreign competitors could be removed quickly thereafter.

The EC had reluctantly accepted this rationale and signed a deal with Canada to partially settle the EC Panel Report that took account of the need for IPBs to lead international restrictions in being dismantled.[466] Moreover, the EC had not pressured Canada to implement this understanding even when a limited IPB deal was concluded between Ottawa and the provinces in January 1991.[467]

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[465] On cost-of-service, the US charged that (Statement of the US at the first substantive meeting of the Panel examining provincial marketing practices on the import, distribution and sale of certain alcoholic drinks by provincial marketing agencies. 23 April 1991): "The Government of Canada has failed to meet the standard established by the members of this Panel in 1988. Instead, it has produced audits from independent accounting firms designed to justify the cost-of-service methodologies adopted in the various provinces. These audits do not stand up to scrutiny. As demonstrated by the audits provided as appendices to the US and Canadian submissions, these differentials go well beyond additional overhead costs that are incurred regardless of the number of sales, as well as the 'imputed' costs that are not actually incurred by the liquor boards. Moreover, to the extent that the costs reflected are generated as a result of practices that the members of this Panel found in 1988 to be GATT-inconsistent, or that the United States has demonstrated are GATT-inconsistent, such costs cannot legitimately be included in the calculations."

[466] That the EC was reluctant is confirmed by its aggressive intervention in the US Panel process. Its submission to the Panel states (Submission of the EC to the Panel examining provincial marketing practices on the import, distribution and sale of certain alcoholic drinks by provincial marketing agencies. 23 April 1991) that: "The Community asked to intervene in this dispute settlement procedure because it was the original complainant in the Panel on Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies (5 February 1988), which has not yet been fully implemented by Canada. That Panel concerned practices with respect to wines, spirits and beers. The Community and Canada have since reached an agreement which we believe should progressively eliminate the discriminatory practices with regard to wines and spirits, provided that Canada implements properly the provisions on costs of service. However, with respect to beer, that agreement only contains a commitment with respect to the ending of discrimination with regard to listing/delisting practices. In other words, there has never been satisfactory settlement of the problems of discriminatory markups or of the availability of points of sale for beer. Although we are negotiating with Canada in good faith in order to find such a settlement, it is our view that, at this time, there is no reasonable prospect for such a settlement."

[467] A comprehensive agreement designed to eliminate interprovincial barriers to trade had to wait until 1995 when a deal between the Provinces covering 11 specific industry sectors including alcoholic beverages was framed.

The US was aware of the Canada-EC deal. However, Washington refused to concede that the US was in any way obligated to wait patiently for Canada to dismantle IPBs before US brewers could enjoy enhanced access to the Canadian marketplace.

Moreover, in its submission to the Panel, Washington stated that the removal of IPBs could actually worsen conditions for US brewers. The US argued that any increase in trade in Canadian beer because of an IPB agreement would likely come at the expense of greater market access for US beer imports.[468]

Lastly, the US suggested in its submissions that CUSTA was a relevant factor to be weighed. However, as opposed to invoking CUSTA as a dispute settlement option, as Canada's brewers had urged DFAIT, the US cited the agreement to demonstrate that Ottawa had ample ability to force GATT compliance in the alcoholic beverage sector on the provinces.

The US provided the Panel with a copy of Chapter 8 of the CUSTA which stated that Canada's federal government could promulgate regulations "... concerning the internal sale and distribution of wine and distilled spirits, which would apply in any given province...."[469] In essence, the US argued that if Ottawa could enforce Chapter 8 of the CUSTA, it should be able to ensure that provincial liquor boards adhered to Canada's GATT obligations.

Canada Responds to the US Submission

Canada began its series of submissions to the Panel by noting that significant steps had already been taken to forge agreements with its trading partners to address many of the issues raised by the US.

The first was the Canada-EC agreement responding to the recommendations of the 1988 EC Panel report. Canada took the position that this agreement, with the full support of the provinces, represented a complete settlement of the long-standing dispute with the EC over spirits and wine. By virtue of its application on a MFN basis, it had enabled Canada to bring its practices on these two products into full conformity with its GATT obligations as defined by the 1988 Panel report.

Canada acknowledged that the phase-out of the discriminatory mark-ups on wine produced in Ontario and BC from 100% Canadian grapes would end only in 1998 in recognition of the severe competitive threat posed to the domestic industry by European imports. However, Canada indicated that the steps taken should be sufficient to ensure the observance of the provisions of the General Agreement by the provincial liquor boards with respect to these two products.

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[468] First submission of the US government to the Panel examining the import, distribution and sale of certain alcoholic drinks by Canadian provincial marketing agencies. (19 March 1991).
[469] Second submission of the US to the Panel examining the import, distribution and sale of certain alcoholic drinks by Canadian provincial marketing agencies. (7 May 1991).

On beer, Canada argued that it had made substantial progress. For example, the Canada-EC Agreement provided a resolution for the listing and delisting of beer. On pricing, the only specific provision to date was a standstill against increasing any mark-up differential that existed on December 1, 1988. Both these provisions were applied on a MFN basis.

Moreover, a side letter with the EC committed Canada to bring pricing on beer into conformity once the intergovernmental negotiations on interprovincial barriers to trade in alcoholic beverages had been successfully concluded. No specific date, however, was indicated as to when this would occur. In addition, it was not possible, in those negotiations, to agree to any commitment on distribution.[470]

The second agreement that Canada reported on was in the area of IPBs. Canada submitted to the Panel that:

> The Government of Canada is strongly committed to the removal of provincial barriers to trade. These can have a profound effect on our competitiveness. These barriers are widespread in the area of alcoholic beverages, particularly beer. Canada, therefore, considers the recently signed Intergovernmental Agreement a major achievement.... The political endorsement of this process has been at the highest level: The Prime Minister of Canada and the ten provincial premiers.[471]

Canada next defended specific elements of the various liquor board practices then in place, including: minimum pricing, environmental standards, distribution and retailing policies. Canada advanced the view that each of these practices was fully consistent with its obligations as set out in the 1988 EC Panel. If there were gaps, steps were underway to ensure that they would be filled within a reasonable time.

On the issue of the US insistence that the Panel first make a ruling on Canada's failure to take 'reasonable measures' to adhere to the 1988 EC Panel, Howie Wilson, Canada's principal negotiator for the Panel phase of Beer 1, argued the following:

> As a first point, and one which I believe we should dispose of finally today, I must disagree with the

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[470] Second written submission of Canada to the GATT panel examining provincial practices on the import, distribution and sale of certain alcoholic drinks by provincial marketing agencies. (7 May 1991).

[471] Second written submission of Canada to the GATT Panel examining provincial practices on the import, distribution and sale of certain alcoholic drinks by provincial marketing agencies. (7 May 1991).

> characterization that the US places on the position of Canada in the Council with respect to their request to have rights for the US affirmed as a result of the 1988 panel report. In response to the US request, Canada explained to the Council that it was meeting its obligations of taking reasonable measures to bring its practices into line with the GATT. Canada rejected the US claims with respect to listings and advised Council that most of the provinces were already in compliance on pricing. In addition, we were in negotiations with the EC with respect to the outstanding matters. In these circumstances, the only proper way for the Council to address the rights of another party when these rights are in dispute is through the dispute settlement process. Canada has agreed to have the matter examined by this Panel to permit a full examination of the facts and the arguments. The US approach in Council was to attempt to deny Canada a full and fair hearing. No contracting party, not even the US, would accept such a tactic.[472]

Given the importance of the US request for an expedited ruling on its rights under the 1988 EC Panel Report, the GATT Panel hearing the US-Canada case moved rapidly to render a decision, which was published on 23 May 1991.

In one of the few bright spots for Canada in Beer 1, the Panel supported Ottawa's position. In its ruling, the Panel denied the US request to retaliate based on the 1988 EC Panel Report, and opted instead to undertake a full investigation of provincial liquor board practices before rendering a judgment on the US complaint.[473]

This was a positive outcome for Canada. It meant that the Panel would treat Beer 1 as a fresh case and fully consider all the facts presented. A ruling against Canada would have been an explicit acknowledgement of non-compliance by provincial liquor boards with the 1988 Panel Report. Any argument Ottawa could have made in defence of provincial liquor board practices after a negative judgment would have been *pro forma* given that an unfavourable Panel decision could be the only result.

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[472] Oral Statement by Canada at the second meeting of the GATT panel examining practices on the import, distribution and sale of certain alcoholic drinks by provincial marketing agencies (23 May 1991).

[473] The text of the Panel ruling (23 May 1991) was as follows: "The Panel has given careful consideration to the United States' request for expedited proceedings, i.e. for the Panel to make an immediate determination that benefits accruing to the United States under the General Agreement had been nullified or impaired as a result of the practices maintained by the Canadian provincial marketing agencies and examined by us in 1988. We have now been informed by Canada that changes have occurred with respect to most of the matters dealt with by us in 1988. We, therefore, believe that before we could make the immediate determination sought by the United States, we would have to make this detailed factual analysis before we could consider whether the Government of Canada has, since 1988, taken such reasonable measures as are available to it to have the provincial agencies bring their practices into line with our findings. In other words, we cannot proceed on an expedited basis with respect to the measures in the first liquor board panel report."

This ruling was virtually the only good news that Canada would receive in the Beer 1 Panel process. A draft of the Panel's report was distributed to the disputants in September 1991 – and, on virtually every point of contention, Canada was found to be in violation of its GATT obligations.

The Panel Reports

On the positive side for Canada, the Beer 1 Panel ruled that the United States did not substantiate its claim that the provincial liquor boards had discriminatory listing and delisting practices, other than Ontario, nor did it prevail on container taxes or the issue of notification procedures. However, Canada lost on virtually every other issue. For example: the requirement in Ontario that imported beer be sold in the six-pack size, while no such restriction existed for domestic beer; the restrictions in every province except Prince Edward Island and Saskatchewan on access of imported beer to points of sale; the prohibition on private delivery for imported beer in Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland, Nova Scotia, Ontario and Quebec; the preferential mark-up for domestic brewers in all provinces except Prince Edward Island, as well as the methods of assessing mark-ups and taxes on imported beer; and lastly, the minimum price system for beer in British Columbia, New Brunswick, Newfoundland and Ontario was found to be inconsistent with Canada's obligations under the GATT, to the extent that the minimum prices were fixed in relation to domestic beer prices.[474]

The Panel concluded that:

> … Canada's failure to make serious, persistent and convincing efforts to ensure observance of the provisions of the General Agreement by the liquor boards in respect of the restrictions on access of imported beer to points of sale and in respect of the differential mark-ups, in spite of the finding of the CONTRACTING PARTIES in 1988 that these restrictions and mark-ups were inconsistent with the General Agreement, constituted a violation of Canada's obligations under Article XXIV:12 and consequently a *prima facie* nullification or impairment of benefits accruing to the United States under the General Agreement.[475]

The Panel then recommended that the Contacting Parties request Canada:

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[474] Beer 1 Panel Report. (1991)
[475] Beer 1 Panel Report. (1991)

1. In respect of access to points of sale and differential mark-ups, to take such further reasonable measures as may be available to it to ensure observance of the provisions of the General Agreement by the liquor boards in its provinces;
2. In respect of the other measures found to be inconsistent with the General Agreement, to take such reasonable measures as may be available to it to ensure observance of the provisions of the General Agreement by the liquor boards in its provinces;
3. To report to the CONTRACTING PARTIES on the measures taken in respect of access to points of sale and differential mark-ups before the end of March 1992 and in respect of the other matters before the end of July 1992.[476]

Canada Responds to the Panel Report

On learning of the Panel's devastating conclusions, Canada's brewers moved quickly to urge DFAIT and provincial officials to work together to fashion a response. The brewers' goals in this process were to ensure that any regulatory changes proposed would permit them to retain and possibly improve their respective competitive capabilities while at the same time responding in a defensible manner to the Panel's recommendations. There was great concern amongst members of Canada's brewing industry that various provinces – or potentially even Canada's federal government – might take steps to comply with the Panel Report in haste without fully considering all of the response options available.

To ensure that Canada presented a thoroughly vetted reaction to GATT Council, the BAC wrote the Director of the GATT Affairs Division, DFAIT, Brian Morrisey, to request that:

> … [Canada's] federal government consider convening a joint meeting with provincial officials and representatives of the industry to review the Panel Report before any provincial actions are initiated or general public discussion by any interested parties takes place on the Report. This is consistent with the close cooperation between both levels of government and our industry through the GATT negotiations and will ensure that public statements and/or actions are not taken that may limit or prejudice options available to us in responding to the Panel Report recommendations. It will also help us all to reach, wherever possible, a common interpretation of the Report's implications as we work together to identify

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[476] Beer 1 Panel Report. (1991)

> and manage whatever transition measures may be appropriate.[477]

DFAIT responded to the industry's request by convening a meeting on 28 October 1991 in Ottawa that brought together representatives from a number of federal departments, the provinces, the industry and brewery worker unions. The meeting was chaired by DFAIT's Doug Waddell, Director-General of the Trade Agreement Bureau, who was assisted by Brian Morrisey, Director of the GATT Affairs Division, and Robert Knox, Director General of the Policy Services Branch of Industry, Science and Technology Canada (ISTC) and head of the Secretariat attached to the Federal-Provincial Technical Committee investigating the dismantling of interprovincial barriers in the beer sector.

Waddell opened the session by relating that the GATT Panel report would be circulated to the contracting parties imminently. This meant that GATT Council would first consider the Panel Report during its Annual Ministerial on 3-5 December 1991. Canada would not accept the report at that meeting as Ottawa had decided to opt for the customary one meeting pass on adoption. Consequently, consideration of the Panel Report would be shifted to the first meeting of the GATT Council in the New Year, currently scheduled for February.[478]

Members of the DFAIT delegation then took turns describing a consultation session held with representatives of the USTR on 8 October 1991 (at the request of the USTR) to discuss Canada's planned response to the Panel Report. Canada did not take a position at the session advising the US that there were extensive discussions underway with myriad internal stakeholders and that it would not be possible to be precise on a response until these consultations were completed.

The USTR officials described their interpretation of the Panel Report and sketched out a list of demands for resolving the dispute with Canada, which included: the option for US brewers to establish their own private (wholesale) delivery services, with no restriction by provincial regulators; equal access to all points of sale – though in Ontario they did not want to be forced into Brewers Retail (BRI); non-discriminatory listing practices, as well as equal access to LCBO 'combo' stores;[479] removal of all minimum pricing mechanisms; and, further 'validation' of the cost-of-service charges in place at the various provincial liquor boards.[480]

The USTR officials also suggested that they wished to resolve any issues with Canadian provincial liquor boards on a 'commercial basis' and not have discussions too tightly limited by strict interpretation of trade law.[481] And, finally, they wanted all access issues cleared up by March 1992 – which would allow US brewers to take advantage of the summer 1992 beer selling season.[482]

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[477] Letter from Sandy Morrison, President and CEO, Brewers Association of Canada, to Brian Morrisey, Director GATT Affairs Division, Canada's Department of Foreign Affairs and International Trade. (10 October 1991).

[478] Waddell also intimated that Canada had been forced to block efforts by the US to accelerate distribution of the report that would have moved GATT Council consideration up to November.

[479] LCBO 'combo' stores were outlets that operated in Ontario as joint Brewers Retail and LCBO retailers.

[480] BAC memo. (9 October 1991)

To add force to their demands, the USTR representatives reminded the DFAIT officials that this particular complaint had been initiated under the auspices of Section 301 of the US Trade Act, which required the USTR to render a decision and take action by the end of December 1991.[483]

The DFAIT officials closed their report of the meeting by noting that there had also been a general discussion of future sessions, though no dates were set. The DFAIT officials also pointed out that, while retaliation was always a possibility – especially given the aggressive hand played by the US to date and the overwhelming nature of Washington's victory in the Panel Report – it was not mentioned by the USTR representatives as something they were considering at that time.[484]

Stakeholder response to the DFAIT situation report was cacophonous. A number of representatives from the provinces and the unions spoke at the session to express frustration. However, few had any constructive ideas on how a Canadian response to the Panel Report could be fashioned.[485]

Benefiting from extensive advice proffered by their trade consultants in both Ottawa and Washington, Canada's brewers had come to the stakeholder session expecting that they would in all likelihood have to step up and lead the consultation process required to draft a response to the Beer 1 Panel Report.

Sandy Morrison described the process proposal that the brewers then advanced at the session in a later report to the members of the BAC board:

> The industry pointed out that they had underway a thorough review of the GATT Panel report involving provincial brewing executives, discussion with provincial government officials, and advice and

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[481] A curious conclusion when lined up with the specific demands of USTR. For example, to suggest that US brewers could desire any other resolution to the issue of access to the Ontario marketplace than full participation in BRI demonstrated a lack of understanding on the part of US trade negotiators of the 'commercial' import of that system. This points up an issue that often occurs in the world of trade negotiations. That is, while a country's trade negotiators may be experts on trade law, they can be ill informed on the actual impact of the positions they take in international trade negotiations. That is why trade negotiators often consult closely with industry experts to formulate negotiating positions. Evidently, it did not happen in this instance.

[482] BAC memo. (9 October 1991)

[483] BAC memo. (9 October 1991)

[484] BAC memo. (9 October 1991)

[485] The BAC board report (BAC memo. 9 October 1991) described the response in the following terms: "It was clear from the interventions of some of the provinces and union leaders present at the meeting that there was no concept of how the consultations should be handled and the necessary consensus developed to provide these responses."

> counsel from its independent trade advisors. Over the next four weeks this process was expected to lead to: (1) An outline of available options and alternatives within each provincial jurisdiction to bring practices into conformity with the GATT as identified by the GATT Panel; (2) The preparation by the industry of specific recommendations on which of the options would be most appropriate for each jurisdiction, taking into account the need for them to be consistent on a national basis; (3) To review the issues of transition and conversion timetables.[486]

As there were no alternative proposals tabled that day, the meeting closed with all stakeholders indicating their support for the industry plan. Federal negotiators, adopting their conduit stance, volunteered that, provided there were no major incongruities with Canada's overall trade policy, they would be pleased to bring the product of these discussions forward for consideration.

With the stage thus set, both Canada and the US turned their attention to the negotiations that would now be required to settle the dispute. These events will be the focus of Chapter 8.

Analysis

As the 1980s ended and the decade of the 90s began, both Ottawa and Washington were investing significant political and economic capital in buttressing the mantle of 'free trade.' Not only had the two countries sealed a bilateral pact in 1988, but also Canada and the US were in the process of extending free trade to include their other continental partner, Mexico.

With all that had been invested in facilitating the burgeoning 'intracontinental' flow of goods, the US and Canada ought to have been working closely together to ensure that the institutional architecture of globalization operated smoothly. If there were trade disputes, both governments should be cooperating to defuse them quickly and with minimum rancour. However, this did not happen with the beer dispute.[487] Why?

Unlike previous chapters, a rational reckoning of the material interests at stake for both parties in the events covered by Chapter 7 is not particularly satisfying as an explanation. If it were, in all likelihood the beer wars may not have occurred.

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[486] BAC memo. (9 October 1991).

[487] Nor was it to be the case with softwood lumber, BC salmon, telecommunications and publishing. However, the dynamics of these disputes differ significantly from the beer challenge. In each of these situations, the actions of both Canada and the US better fit the null hypothesis as there was far more at stake and, as a consequence, much more political involvement on both sides of the border.

Canada's actions during this phase of the beer dispute are better accounted for by deploying alternative hypotheses that focus on the impact of epistemic communities.

As noted in Chapter 6, an epistemic community existed amongst Canada's DFAIT officials girded by a series of mutual understandings about the importance of fostering increased trade between Canada and the US as a means of improving the competitiveness of Canadian industry. These officials also shared views on the trade distorting impact of provincial liquor board practices, the importance of keeping beer out of the CUSTA dispute settlement mechanism, the protected nature of Canada's brewing industry and the need for IPBs to be dismantled to allow Canadian industries to develop national economies of scale.

The USTR's pursuit of a Section 301 action to assist Heileman and Stroh in cracking the Canadian market was seen by DFAIT officials as an ideal opportunity to dismantle IPBs without engaging in a potentially bruising federal-provincial showdown. Blame for the necessity to change provincial liquor board practices could be laid fortuitously at the doorstep of the USTR in Washington.

It is little wonder then that DFAIT officials operated principally as dispassionate conduits between the provinces, Washington and Geneva in this phase of the dispute. While there was an occasional need for Ottawa to engage Washington with at least some 'public' intensity to mitigate criticism from internal stakeholders, for the most part DFAIT officials were able to observe from the sidelines as Washington's efforts fulfilled DFAIT's vision for Canada's beer industry.

Accounting for US actions during this phase of the beer dispute is a more complex undertaking than explaining Canada's dealings. It requires a closer examination of some of the endogenous factors and exogenous forces that contributed to the USTR's decision to press Canada on provincial liquor board practices.

The US rationale for moving against Canada is not as simple as pointing to the healthy mistrust and dislike trade analysts at USTR held for the provincial liquor boards. While personal animosity was clearly building amongst USTR staff, there was nothing approaching a groundswell of support at USTR for Heileman's case. In fact, as noted in the case data, the strongest argument USTR staff could muster for the decision to move was that Heileman's petition had 'legal merit' and thus deserved to be tested.

Moreover, despite the views of some USTR officials interviewed for this dissertation, domestic industry lobbying was an important, though not the essential motivation for US action. Much of the US industry's lobbying effort could have been enervated by the USTR if the agency had chosen to actively oppose the US brewers in Washington.

For example, Anheuser Busch could have been countered readily by the USTR revealing publicly that the St. Louis-based brewer had a very lucrative licensing deal with Labatt Breweries in Canada that allowed it to profit handsomely from the practices of provincial liquor boards. In fact, Anheuser Busch had the fastest growing imported brand in Canada – Budweiser.

If the USTR wanted to attack Anheuser Busch lobbying further, it could have shown that the brewer's complaint was more about its own narrow corporate agenda – i.e. a concern about Canadian bottle preferences migrating south - than any particular economic hardship it was enduring at the hands of the provincial liquor boards. This is hardly the stuff of which disputes with your closest trading partner are born.

As for de-fusing the pressure of Heileman and Stroh, the USTR should have been able to point out without much trouble that both brewers were economic cripples and unworthy of a trade fight with a vulnerable Canadian government then under domestic political attack for, among other things, entering the CUSTA. Moreover, Heileman was not even an US-owned corporation. It was held by a notorious Australian entity, cash-strapped because of the enormous debt it had assumed when it had purchased Heileman in the first place.

All this is to say, if the USTR had desired to stave off its domestic industry's lobbying effort, it had more than enough ammunition to do so.

Yet, it would not have been possible for the USTR to pursue Canada any more aggressively on beer than it did and still respect its own Section 301 review process and the GATT dispute settlement procedures. Not only was every deadline as truncated as it could be, the US went so far as to request retaliation based on the 1988 EC Panel. Why did Washington – arguably, as noted above, under little domestic political pressure - push so hard for such scant reward and potentially put at risk its relationship with its largest trading partner?

The answer is that USTR officials understood that they were not hazarding anything of consequence in the US relationship with Canada by going after the provincial liquor boards. It is important to note that this knowledge was not borne necessarily of planned and deliberate coordination between the officials in DFAIT and USTR. While there is evidence in the record that some coordination did occur, there is no compelling proof that it was either widespread or a primary determinant of events.

Rather, the most important coordination that took place was driven by a series of shared understandings between Canadian and US officials about how the beer disputes should be managed. These shared understandings were the core of the DFAIT-USTR epistemic community that operated between trade officials during the Canada-US beer dispute. These officials did not need to synchronize their activities directly. Because of their shared understandings, they knew almost instinctively what needed to be done, and for the most part, they did it.

The DFAIT-USTR epistemic community differs from the domestic DFAIT epistemic community in that understandings were shared – or 'diffused' - across a border rather than within a single department of government. However, the shared understandings between the officials were virtually identical to those of the DFAIT domestic epistemic community. Their nexus was a desire to remove the impediments to trade between the two countries that served to arrest industrial development. And, both DFAIT and USTR officials agreed, there were no trade barriers more deserving of attention than those created by provincial liquor board regulations.

In discussing the impact of the DFAIT-USTR epistemic community on events, it is important to recall that the beer dispute was managed primarily at the officials' level. Politicians were involved occasionally either to communicate publicly on the issue or if political endorsement of an initiative was needed to allow it to proceed. As one trade expert advising the Canadian industry noted in an interview for this dissertation:

> The beer dispute was almost entirely a bureaucratic initiative. Michael Wilson [Canada's Trade Minister toward the latter part of the dispute] was involved when he was needed – but that was about it. As for Washington, there was no great political involvement at any stage of the process.[488]

A USTR interviewee echoed this perspective:

> There were some congressional letters to the USTR during the dispute. But, they really didn't make a difference. This whole dispute was really inside the house at the USTR.[489]

The reason this lack of political involvement is important is that it created the 'space' required for the epistemic community involving Canadian and US trade officials to gestate and flourish.

As noted in Chapter 2, epistemic communities exert influence in highly technical issue areas where politicians either lack the competence and thus the confidence to make decisions, or there is not enough at stake politically for them to choose to engage. Both are true in terms of this stage of the beer dispute.

Another factor to consider is that these trade officials were not strangers to each other. As noted previously, officials at DFAIT and the USTR had multiple opportunities to interact over the course of their careers as negotiators on various trade disputes. Because of these contacts, relationships were formed that affected the outcomes of the disputes that they managed. As a senior DFAIT official interviewed for this dissertation noted:

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[488] Dissertation interview.

[489] Dissertation interview.

> If you have a relationship you can get past the 'BS' and it becomes much easier to get an agreement on certain things. It makes negotiations much easier if you know the person across the table. Moreover, it can even go as far as the two negotiators jointly mapping out solutions that each will then try to get their domestic constituencies to agree to.[490]

An example of a 'joint solution' that officials settled on at this early stage of the Beer 1 talks was the need for the dispute to be solved on a 'commercial' basis. On the surface, this seems to be a rather benign and perhaps even a practical way to proceed. The complexities of trade law can often get in the way of negotiating agreements that actually make commercial sense for the companies involved. Therefore, a commercial solution appeared to be a logical approach to managing negotiations for most stakeholders at the time.[491]

However, by choosing to search out a 'commercial' solution, Canada was in fact abandoning some of its most important GATT-legal defenses for provincial liquor board regulations. The consequences of deciding on a 'commercial' approach to resolving the dispute will be one of the issues engaged in Chapter 8.

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[490] Dissertation interview.

[491] In fact, the proposal to negotiate a 'commercial' solution was heartily endorsed by Canada's brewers.

Chapter Eight

Negotiation, Retaliation, Resolution

Introduction

This chapter covers the final phase of the Beer dispute. It begins with an examination of the maneuvering by both Canada and the United States before entering negotiations to settle the Beer 1 Panel Report. It moves on to discuss the decision of the US to retaliate against Canada, and Canada's counter-retaliation against US beer imports into Ontario. The narrative then shifts to describing the bilateral talks that led to the framing of the Memorandum of Understanding (MOU) that settled the Canada-US beer wars. The chapter concludes with an assessment of the explanatory efficacy of the statist hypothesis as well as the two alternative hypotheses being employed to test the epistemic community concept.

US Resolve Stiffens

With a clear Panel win and the USTR staff continuing to hold an interest in pressing the provinces to change the commercial practices of their liquor boards, and likely fortified by signals from DFAIT that Ottawa would be measured in responding at the GATT, Washington stepped up its pressure on Canada.

Whereas retaliation had not been mentioned by USTR staff in their first, informal 'information sharing' negotiating session with DFAIT - reported on by DFAIT during the Ottawa stakeholders meeting and discussed in Chapter 7- it was now clearly being mulled over by Washington.[492]

The US saw retaliation as justified because the provinces had been aware since at least the MTN negotiations, and had further reinforced by the EC Panel Report, that provincial regulatory regimes for managing alcoholic beverages had to be overhauled. Yet, knowing this, Ottawa and the provinces seemingly availed themselves of virtually every procedural opportunity at the GATT to avoid making changes – including requiring the US to take the issue once more before a GATT Panel. To make matters worse, when the provinces did introduce changes, Washington felt that the cure offered was often worse than the disease it portended to treat. The result was that the competitive opportunities for US brewers in the Canadian market withered with each passing day.

USTR officials further believed that the United States did not have to await the conclusion of any further deliberations by GATT to retaliate against Canada. Unless Canada committed quickly to making real change, Washington was prepared to withdraw concessions immediately for a number of Canadian products – including, but not limited to, Canadian beer and whisky.[493]

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[492] DFAIT's Brian Morrisey reported to the BAC (BAC memo 25 October 1991) that retaliation was mentioned in a meeting between the staffs of the US embassy and DFAIT in Ottawa.

While some of Canada's brewing companies privately held the view that the USTR's interest in retaliation may just be posturing to weaken Canadian resolve on the eve of negotiations, the BAC took the precautionary step of dispatching one of its own trade consultants to meet with USTR staffers to corroborate the threat.

The BAC consultant reported back that Andy Shoyer and Rick Ruzika of the USTR believed that as the US had won overwhelmingly on all major points considered by the Panel, Washington felt fully justified taking a very aggressive position in its negotiations with Canada – including launching retaliatory action to focus the attention of Ottawa and the provinces on reaching a settlement.[494]

Shoyer and Ruzika also outlined a draft US opening position for negotiations. It covered self-delivery (it must be permitted); points of sale (US brewers must have greater access to Canadian consumers – and should not have to go through Canadian brewery-owned distribution and retail outlets to get it); cost of service (a complete overhaul of the provincial liquor board audits was necessary to ensure that US brewers bore only the actual costs required for the liquor boards to distribute and retail US products); listings (open access to the market for all US brewers who desired it); and, lastly, minimum price (it should be removed – if the provinces want to have a minimum price for social responsibility reasons, they must achieve it, as the Beer 1 Panel Report suggested, via taxation levied against both domestic and imported beer). Shoyer and Ruzika further took the position that changes must be implemented by 1 March 1992 so that US brewers would not miss another summer selling season.[495]

The BAC's trade consultant completed the report of his meeting with Ruzika and Shoyer by noting that:

> We expect USTR to play hardball with the December 29, 1991 deadline under Section 301. I would expect to see a determination against Canada announced on that date as well as a list of proposed retaliation items (including Canadian whiskey and beer) which would be implemented in 30 days time. Shoyer claims that he has political support from within USTR (presumably Deputy USTR Jules Katz) for playing hardball and the State Department is on board.[496]

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[493] BAC memo (25 October 1991).
[494] BAC memo (24 October 1991).
[495] BAC memo (24 October 1991).
[496] BAC memo (24 October 1991).

Canada Responds

On hearing their consultant's report, Canada's brewers went to work on officials at DFAIT to test the department's willingness to weather the looming storm, and further to suggest a strategy that called for widening the number of participants involved so that it would not simply be Canada staring across a table at the US.

This was a departure from the BAC's earlier support for bilateral dispute resolution through the CUSTA. The BAC's perspective had evolved because, while it may have seemed sensible to consider beer on a bilateral basis for the adjudication phase of dispute settlement, direct talks with the US to reach a negotiated resolution were fraught with risk. Most significantly, the brewers were concerned that beer would be rendered a sop for Canada to employ to secure concessions from the US in the ongoing bilateral saga over softwood lumber.

To register this, and other concerns with Ottawa, as well as to present the industry's views on an appropriate strategy for the upcoming talks with the US, Sandy Morrison wrote Don Campbell, Canada's chief bureaucrat for international trade.[497]

Morrison began his letter by noting that Canada's brewers were troubled by recent US threats to publish a retaliation list. He judged that this tactic was being employed by Washington to pressure Canada to make concessions before negotiations could even begin. Morrison further revealed that the Canadian industry had received information that the list could appear as early as the end of November 1991. This would be before the matter had even been discussed at GATT Council or the Panel Report adopted.[498]

Morrison then proceeded to describe the process that the brewers were spearheading with provincial and DFAIT officials to craft a Canadian response to the Panel Report, and further suggested that there was a need for adequate adjustment time to be given to the industry to come into compliance.[499] Moreover, he reminded Campbell that the Beer II GATT Panel launched by Canada against US state and federal regulatory practices governing beer was about to be released and that Canada's brewers believed that it could provide leverage to even the playing field for upcoming negotiations with the US on Beer 1.

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[497] Letter from Sandy Morrison, BAC to Donald Campbell, Canada's Deputy Minister for International Trade and Associate-Undersecretary of State for External Affairs (22 November 1991).

[498] Letter from Sandy Morrison, BAC to Donald Campbell, Canada's Deputy Minister for International Trade and Undersecretary of State for External Affairs (22 November 1991).

[499] Morrison notes that (Letter to Don Campbell, Canada's Deputy Minister for International Trade and Undersecretary of State for External Affairs 22 November 1991): "Under normal GATT practices, as specifically recognized in the Panel decision, Canada is entitled to reasonable time to make the necessary legislative and regulatory changes to effect the Panel findings at the provincial level. We expect the US to try to truncate the process, but given their own foot-dragging on other Panel issues affecting American interests, we do not understand the precipitate actions that are reportedly underway."

This latter point is interesting to consider. DFAIT's attempts to link Beer 1 and Beer 2 were largely half-hearted - though, it would be difficult to fault the DFAIT officials for not pushing harder.[500] Even Canada's brewers did not seem to take the linkage issue very seriously. As one Canadian brewer indicated in an interview for this dissertation, Beer II was "... strictly a bargaining chip."[501]

However, there may have been more opportunity for Canada to link the two disputes than either DFAIT or Canada's brewers believed at the time. Though there was not unanimity at USTR on this issue,[502] one USTR official interviewed for this dissertation suggested that:

> [Beer 1 and Beer 2] ... could have been tied in a negotiation. The Canadian government could have tried it.... It might have been possible – they potentially could have accomplished it."[503]

By not insisting that the two disputes be linked, Canada may have missed a chance to secure some leverage for its talks with the US on Beer 1. However, as in most *ex post facto* discussions of opportunities missed, this is interesting only in that it helps to complete the historical record. There is no evidence available that Canada's negotiators were aware that this view even existed at USTR. Consequently, while DFAIT did advance the notion of linkage perfunctorily,[504] Canada did not insist that the two cases be joined as a precondition for commencing negotiations to settle Beer 1.

On strategy for the upcoming talks, Morrison presented a novel approach. Using the political difficulties that Prime Minister Mulroney was then having on the industrial impact to Canada of CUSTA transition, as well as the fallout from the failed Meech Lake Accords, and also noting that there were indications from brewer contacts in Washington that the US administration was sensitive to the additional burden that a confrontation on beer could place on the ability of Canada to deliver in the NAFTA talks, the BAC CEO suggested that beer could be quietly slipped into the NAFTA negotiations to secure a settlement.[505]

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[500] A DFAIT official interviewed for this dissertation noted that (Dissertation interview): "There was no doubt that Beer II was simply a card we could play in discussions with the US."

[501] Dissertation interview.

[502] Another USTR official noted (Dissertation interview) that: "Canada made some attempts to press linkage – but, there was no way that the US was going to accept it."

[503] Dissertation interview.

[504] Dissertation interview.

[505] Morrison noted that (Letter from Sandy Morrison to Don Campbell, Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs. 22 November 1991): "At the most senior levels in the US administration, there is a desire to ease the pressure on Prime Minister Mulroney in recognition of his political difficulties arising from internal constitutional wrangling, and criticism that CUSTA has done little to protect Canada from arbitrary and unilateral US trade actions."

This was an ingenious line of attack. By inserting beer into the NAFTA process, Canada could presumably ally itself with the Mexican brewing industry, which was similarly protected from cheap US beer by an umbrella of regulation. Moreover, Canada's brewers, in tandem with their Mexican counterparts, could place themselves in a position where the political dynamics that operated during the CUSTA talks, which saw Canadian beer largely exempted from that agreement, could once again be activated. If all else failed, the fallback position might be the deal that wine and spirits had secured in CUSTA that allowed a ten-year transition period to implement change. This was significantly better than the prospect of facing down the US in a bilateral discussion focused on the Beer 1 GATT Panel report.

However, before the brewers could mount a strong lobby to pressure DFAIT, Washington acted to force Ottawa's hand. On 27 November 1991 the USTR published a Federal Register notice stating that if Canada and the US did not reach a mutually satisfactory resolution of the beer dispute by 29 December 1991, the USTR would explore opportunities within the scope of Section 301 of the Trade Act to compel Canada to comply with its GATT obligations. The notice further stipulated that among the actions the USTR was considering were the suspension of duty bindings and an increase in duties on Canadian beer and other alcoholic beverages from Canada.

With the publication of the Federal Register notice, and also to respond to a number of leaks to the media of the confidential Beer 1 Panel Report, Ottawa was forced to take an aggressive public position in defence of Canada's brewers. In replying to questions by a writer for Canada's Financial Post newspaper about the US threat to retaliate, Trade Minister Michael Wilson (who had replaced former Minister John Crosbie):

> … [S]lammed as 'inappropriate and premature' moves by the US to retaliate against Canadian beer exports….' In admitting for the first time that Canada had lost the panel ruling, Wilson said the threats were inappropriate because Canada had already told the US it would comply with the GATT Panel by as early as March. 'The US announcement is inappropriate because it threatens action on a GATT panel report before the report has even been considered by the [full] GATT Council', said Wilson, referring to a GATT Council meeting scheduled for February.[506]

While the public positioning of DFAIT's Minister was impressive, DFAIT did little either with the US on a bilateral basis or at the GATT to back up his aggressive remarks. For example, Canada did not threaten to take any meaningful action in any other trade dispute with the US or in the ongoing NAFTA negotiations to suggest that any sanctions might result from the US continuing to threaten retaliation.

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[506] Peter Morton. 'Wilson ready for beer war with US.' Financial Post (29 November 1991).

This duality of public aggression paired with a private shrugging of shoulders was further demonstrated by Canada's response to the Panel Report at the 3-5 December 1991 meeting of the of the GATT Council. While Canada used the opportunity to excoriate US actions in its public pronouncements,[507] it also indicated during the session that Ottawa would accept the Panel Report at the first regular meeting of GATT Council in 1992.

While Canada's brewers were delighted with the aggressive tone of Ottawa's public pronouncements,[508] they also recognized that there was little buttressing the rhetoric. When Canada did not even attempt to delay acceptance of the Panel Report beyond the *pro forma* interval of a single meeting – a tactic which, ironically, Canada's representative to the GATT Council noted was commonly followed by the US under similar circumstances[509] - Canada's brewers understood that DFAIT's determination to resist the US remained as evanescent as ever.

To help shore-up DFAIT's resolve, the brewers took the position with department officials that they were ready to absorb US retaliation. Sandy Morrison communicated this message to Don Campbell in a letter on 17 December 1991.[510] Moreover, the brewers pitched the fruits of their labour with the provinces as a legitimate response to the Panel Report. An essential component of this response package was the need to secure adequate transition time for Canada's brewers to evolve to compete with larger US beer concerns.

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[507] Pierre Gosselin, Canada's representative to GATT Council (Canada's speaking notes to the 3-5 December 1991 meeting of GATT Council) asked that: "I would hope that the Contracting Parties would use this occasion to send a clear and strong message that unilateral measures taken under Section 301 are neither warranted not appropriate in the present circumstances."

[508] In a 19 December 1991 letter to Don Campbell, Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs, Sandy Morrison observed that: "Our members were very pleased at Canada's firm and unequivocal rejection of the US threat to retaliate against Canadian beer exports to the US before the GATT Council adopted the Panel Report and Canada had responded to the Panel recommendations. Indeed, as we stressed, Canada must reject any US attempt to retaliate that is not specifically sanctioned by the GATT Contracting Parties. We are encouraged by your assurance that Canada will continue to fight these arbitrary and high-handed actions by the USTR and will initiate equivalent trade action against US exports to Canada should the US persist in high-jacking the GATT dispute settlement process through precipitous action."

[509] Pierre Gosselin noted in his speech to the GATT Council that (Canada's speaking notes to the 3-5 December 1991 GATT Council meeting): "Deadlines have been established by a Contracting Party which recently blocked the adoption of a report finding its practices inconsistent with the GATT for seven successive meetings of the GATT Council."

[510] In his letter, Sandy Morrison noted that (Letter from Sandy Morrison to Don Campbell, Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs 17 December 1991): "We trust that the US will agree to have this trade dispute, and other alcoholic beverage trade issues, resolved through the established trade dispute settlement processes under GATT and/or the CUSTA. Should they act unilaterally, the industry fully supports a strong and uncompromising response by Canada and is prepared to accept the consequences of US retaliatory action rather than see Canada capitulate to the 'bully-boy' tactics."

The message on transition was also at the forefront of a separate letter written by Sandy Morrison to DFAIT's Doug Waddell, Director-General of the Trade Agreement Bureau on 17 December 1991. In this letter, Morrison specified that:

> … [T]he industry believes that a reasonable transition period is essential to provide the domestic industry with the time to adapt to the new operating environment, to allow both federal and provincial governments to change policies that impose operating disincentives and constraints on the domestic brewing industry, and to allow for the time for governments to introduce and secure the regulatory and legislative change necessary to bring all policies and practices into conformity with Canada's GATT obligations.[511]

In tandem with the provinces and other stakeholders, the brewers also reached back to the DFAIT EC team plan for inspiration to yet again suggest a method that might permit Canada to avoid direct bilateral talks with the US to settle the dispute. They suggested that Ottawa simply bring a response to the Panel Report forward at GATT Council and the US could either take it or leave it.[512]

However, recognizing that even if Ottawa attempted the 'take it or leave it option' at GATT Council, the politics of the situation probably demanded that Canada must engage the US in bilateral talks, the brewers suggested another creative approach to help mitigate the risks associated with one-on-one negotiations with the US.

The brewers recommended that Canada's Ambassador to the US, Derek Burney, approach his US counterpart with the idea of establishing a Binational Commission to consider the dispute.[513] The rationale for this plan hinged on the dispute settlement provisions spelled out in Chapter 18 of the CUSTA. The brewers also suggested that there had been precedents prior to the CUSTA for this kind of approach.[514]

The Commission would be composed of industry experts from Canada and the United States capable of responding on a 'commercial' basis with government observers to monitor the process. The brewers pointed out that the focus on a commercial solution was not intended to stall resolution, but rather to ensure that the solutions arrived at were practical for brewers in both Canada and the United States. Lastly, the brewers recommended that the Commission mandate cover "… all bilateral dispute issues within the alcoholic beverage sector," and that a report be produced within 180 days.

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[511] Letter from Sandy Morrison to Doug Waddell, Director-General, DFAIT Trade Agreement Bureau (17 December 1991).

[512] Letter from Sandy Morrison to Doug Waddell, Director-General of DFAIT's Trade Agreement Bureau (17 December 1991).

[513] BAC memo (16 December 1991).

[514] However, the BAC's memo does not suggest what these precedents were. (BAC memo 16 December 1991).

The brewer's recommendation that the Commission focus on all disputes within the alcoholic beverage sector was clearly a further effort to level the negotiating playing field by linking Beer 1 to Beer 2. However, as with all of the previous attempts made by the brewers to reshuffle the deck to catch a better hand before sitting down to a game of high stakes poker with the US, the strategy was scuttled by US pressure and Ottawa's indifference to resisting Washington with anything approaching resolve.

The Pressure Builds on Canada

Before face-to-face discussions between Ottawa and Washington could commence, there was the matter of Canada accepting the Beer 1 Panel Report. And, like many of the events in the beer dispute, it was preceded by US brinkmanship.

On 27 December 1991, the USTR announced that it would retaliate against Canadian beer exports to the US if a satisfactory settlement could not be reached by 10 April 1992.[515] The USTR added further impetus to this threat by filing another notice in its Federal Register specifying that:

> … [T]he US Customs Service has been requested to monitor the volume of entries, and withdrawals from warehouse for consumption, of Canadian beer and malt beverages, effective immediately, to ensure the effective implementation of action under Section 301 of the Trade Act.[516]

There were also some concerning developments for Canada's brewers on the domestic front. Discussions with DFAIT officials on drafting a response to the Beer 1 Panel Report raised suspicions amongst Canada's brewers that the DFAIT negotiating team seemed less concerned with mounting a stalwart defense than in ensuring that the provinces changed their practices to conform to DFAIT's interpretation of Canada's trade obligations.

This development represented a departure from DFAIT's previous efforts at stakeholder management. It will be recalled that Canada's negotiators had for the most part avoided confrontation with Canadian stakeholders on the specific terms of positions presented to Canada's trading partners on the alcoholic beverages file. There was no need for DFAIT to do anything but operate as a helpful conduit to achieve its aims. The EC, and the US, in turn, would do all that had to be done to force change on both the provincial liquor boards and Canada's brewers.

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[515] USTR news release. 'US announces action on Canadian beer.' (27 December 1991).

[516] US Federal Register Notice. (3 January 1992).

The industry became so concerned with this apparent change in DFAIT's approach that Barry Joslin of Molson and Lorne Stephenson of Labatt, the senior executives managing this file for Canada's two largest brewers, wrote a joint letter to DFAIT's Doug Waddell on 7 January 1992 specifying the following:

> ...[W]e feel compelled to write to you because, as the federal-provincial consultations continue, we are becoming increasingly concerned that some of your officials are urging interpretations of the Panel report which go beyond what the Panel found. It is our impression that these officials are advocating on some issues a policy of concession and appeasement rather than one of aggressively exploiting possible Canadian advantages in the actual terms of the Panel Report. This certainly is not the image that Minister Wilson is trying to project. It is clearly not an approach our companies can accept. We strongly believe that this is an unwise strategy for any response and subsequent consultation with the US.[517]

Why DFAIT officials charged with consulting the Canadian stakeholder group chose this particular moment to depart from their previous strategy is difficult to determine. Perhaps it was because they were concerned about offending the US by taking too aggressive a stance at the GATT, or maybe they were anticipating negative fallout that might affect another trade file. Alternatively, it might have been because they simply saw the industry strategy as an affront to their free trade beliefs. There is no clear answer in the record to this question

Whatever the reason, the intervention by Joslin and Stephenson seemed to have the affect that the brewers desired. The DFAIT negotiators reverted almost immediately to their conduit role. The evidence for this assertion is that the Canadian submission to the GATT Council on the Beer 1 Panel Report was virtually identical to what the industry requested.

The theme of the Canadian response to GATT Council was of the 'take it or leave it' variety proposed earlier by the brewers. Canada presented what each province was willing to do to amend its liquor regime to come into compliance with Beer 1 over the course of the next three years. Having thus met GATT's 'reasonable measures' test, Canada stated that no further negotiations were required with the US except as they might relate to specific implementation of the proposed plan.[518]

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[517] Letter from Barry Joslin and Lorne Stephenson to Doug Waddell, Director-General for DFAIT's Trade Agreements Bureau (7 January 1992).

[518] The Canadian submission stated flatly (Canadian submission to GATT Council on provincial beer marketing practices, 31 March 1992) that: "Canada considers that in taking these measures it has fully met the requirements of Article XXIV:12 of the General Agreement. Canada is willing to consult with any interested contracting party on the implementation of the panel's recommendations."

In its submission, Canada committed the provinces to implementing the following measures:

- In the province of Ontario, imported beer will be accorded national treatment. In the future, there will be no prohibition on imported beer being sold in larger package sizes where that right is accorded to domestic products.
- The provinces of British Columbia, Saskatchewan, Manitoba, Ontario, Quebec, Nova Scotia and Newfoundland will ensure that any differential markups, including cost of service charges, will include only those differential costs that are 'necessarily associated with marketing of the imported products' as outlined in the panel's findings. This will include the removal of the differential in the general and administrative components of the cost of service.
- The provinces of British Columbia, Alberta, Manitoba, Ontario, Quebec and Nova Scotia will provide equivalent competitive opportunities with respect to access to retail points-of-sale for both imported and provincially produced beer.
- In the provinces of British Columbia, Alberta, Manitoba, Ontario, Quebec and Newfoundland, both imported and provincially produced beer will be provided equal opportunity with respect to delivery from in-province warehousing to retail points-of-sale.
- In exercising their right to regulate the consumption of alcohol through the use of minimum pricing, the provinces of British Columbia, Ontario and Newfoundland will ensure their pricing systems conform to the panel's conclusions that minimum prices not be fixed in relation to the prices at which domestic beer is supplied."[519]

The proposal was hailed publicly by both the Canadian industry[520] and Canada's federal government[521] as a major step forward in improving access for foreign brewers to the Canadian marketplace. Each stated that the submission struck the correct balance between offering a reasonable enough set of concessions that the US could walk away claiming that its entreaty had been effective, while at the same time permitting Canada's industry the opportunity to evolve without having to endure crippling competition.

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[519] Canadian submission to the GATT Secretariat on provincial beer marketing practices. (31 March 1992).

[520] The BAC said in a news release following the submission (BAC News Release 31 March 1992) that: "[I]t supports the federal and provincial governments in the full response made to GATT on complaints over beer marketing practices. 'The comprehensive measures outlined by the governments will result in sweeping changes to current systems to ensure consistency with international trade obligations, said Howard Collins, Acting General Manager of the Association. 'By March 31, 1995 the market will be completely open to all brewers, both domestic and foreign.'"

[521] A news release by Canada's federal government (News release from the Minister of Industry, Science and Technology and Minister for International Trade. 'Canada responds to GATT Panel report on beer.' 31 March 1992) stated that: "Canada has submitted to the GATT Secretariat today an implementation plan to comply with the recommendations of the GATT Panel report. 'The provinces, industry and unions have been fully consulted in the Canadian response to the GATT panel report,' Mr. Wilson said. 'The package presented to GATT reflects the provinces' implementation plans. The federal government will continue to work in partnership with the provinces and industry as this plan is implemented.'

While both the Canadian industry and DFAIT presented the same view to the public, it was not for the same reasons. For the brewers and the provinces, the presentation of the Canadian position was regarded as a triumph because it was a much less severe result from Beer 1 than they had originally anticipated. However, for DFAIT, the seasoned trade professionals in the department undoubtedly recognized that the position Canada had taken at Geneva was untenable and likely only to fan the flames of the dispute with the US. They had only to stand back and wait for Washington's response. It was not long in coming.

The US Reacts to Canada's Submission

The US was furious at Canada's submission to GATT Council. Julius Katz, Deputy USTR, wrote Don Campbell the day Canada presented its submission to express grave misgivings about what Canada had offered in Geneva:

> I have read with considerable disappointment the text of a 'Communication from Canada' … concerning Canadian provincial practices regarding beer. We are still in the process of studying the full implications of the statement. It is clear, however, that Canada's proposal to modify or eliminate as late as March 1995 market access barriers that, in some cases, were first found to be GATT-inconsistent in 1988 is not acceptable to us, nor do I believe that it will be acceptable to other GATT contracting parties.[522]

To Washington, Canada was again pressing a position designed to shield its brewers for, minimally, one more summer season. Moreover, there was consternation that this response represented the totality of what the provinces were willing to do to come into compliance with Canada's international trade obligations. The US was looking to enter negotiations – and it wanted them ended quickly.[523]

Don Campbell, Deputy Minister of External Affairs and International Trade, replied immediately to Julius Katz. Predictably, he expressed disillusionment on Canada's behalf to Washington's reaction, noting that Canada was taking steps to address all of the issues raised in the Beer 1 Panel Report. He also indicated that the changes Canada proposed were not trivial and in fact involved, in many instances, the provinces amending the legislative basis for their regulatory regimes.

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[522] Letter from Julius Katz, Deputy USTR to Don Campbell, Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs (31 March 1992).

[523] Julius Katz presented the following in his note to Don Campbell (Letter from Julius Katz, Deputy USTR to Don Campbell, Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs (31 March 1992): … [T]he failure of Canada to open its market to US and other imported beer for this year's summer season would be unacceptable. If Canada is not able to move more quickly to fully implement the panel report, we will need to indicate to the GATT Contracting Parties that Canada's implementation plan falls well short of compliance with the panel report. My staff is ready and willing to meet with your staff…. We remain committed to working with the Government of Canada to find a mutually satisfactory resolution of this matter. I look forward to hearing from you."

Campbell employed the issue of legislative change to mask what the Canadian industry and the provinces were really after – time. In making this pitch, Campbell pointed out that the US had often required adjustment time in bringing its own industries into compliance with GATT requirements:

> It is neither reasonable nor realistic to expect that legislative changes be effected for this year's summer season – a view which I believe will be supported by the contracting parties. The US itself has required a number of years to effect the necessary changes to legislation in response to several GATT panel findings (e.g. Superfund, customs user fees, manufacturing clause). US officials were informed that in some cases changes can be made administratively and the timing could be discussed in the context of Canada's overall plan of implementation…. [W]e believe that 3 years is a short but necessary and reasonable transition period for Canadian brewers to adjust to increased competition resulting from implementation of the panel findings.[524]

However, in responding to Katz's letter, Campbell moved away from the 'take it or leave it' approach taken by Canada at GATT Council. Campbell indicated that Canada was in fact willing to enter bilateral talks with the US to settle the dispute.[525]

That Campbell chose this point in the dispute to abandon the 'take it or leave it' approach represented both an understanding of the slim chance that the US would accept it – as noted previously, GATT Panel Reports almost always lead to negotiations between disputants - and also that Canada's domestic stakeholders might be amenable as the specific terms of the proposal were precisely what they had demanded. Moreover, Campbell knew that trade consultants advising both the provinces and Canada's brewers had extensive GATT experience and they would be advising their clients that negotiations with the US were inevitable.[526]

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[524] Letter from Julius Katz, Deputy USTR to Don Campbell, Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs (31 March 1992).

[525] Campbell noted that (Letter from Don Campbell, Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs to Julius Katz, Deputy USTR (31 March 1992): "I reiterate again that we remain willing to consult with the representatives of the US government with a view to finding a mutually satisfactory resolution of this matter. We would be prepared to meet later this week."

[526] To underscore the willingness of Ottawa to engage Washington directly in bilateral discussions, Campbell added a hand-written amendment to his letter that reads (Letter from Don Campbell,

An additional point to consider is that Campbell knew, as would any experienced DFAIT trade negotiator, that entering direct talks with the US would bring a new sense of urgency to resolving the beer dispute. Any veteran Canadian trade official having witnessed the tactics of US negotiators during the CUSTA discussions appreciated that Washington's *modus operandi* was to inject artificial deadlines and US domestic political crises into negotiations to force concessions. DFAIT officials knew that the dynamic of bilateral talks with the US would create a charged atmosphere in which the issues that had beguiled provincial and federal negotiators in the IPB talks for the past decade could be resolved.

Negotiations

The US government kept the pressure on Canada by continuing to signal that it was considering retaliation. Canada's brewers, again seeking independent corroboration, directed their trade consultants to gauge the level of support for retaliation in the Capitol.

After consulting their contacts at USTR and in a number of other US federal departments,[527] as well as officials on the staffs of interested senators and congressmen, and also senior staff at the White House and the National Security Council, the BAC's advisors reported that the US desire to retaliate was not a bluff:

> … [A]ll … [of our contacts] … hope that enough progress can be advanced in the time before April 10 [the US deadline for commencing retaliation] to which the US can point as to real advancement in resolution of the Beer I dispute. However, all … [our contacts] … appear quite prepared for sanctions to go forward after April 10 if more progress than has been made to date is not made. In my conversations, each of these officials talked as if from the same script and all (somewhat surprising to me) had a high degree of awareness and currency of the issue. All talked about US 'credibility' in not going forward with sanctions in light of what was a 'plainly inadequate' Canadian response. Each seemed to suggest that sanctions may be the only way to get Canadian attention and seriousness to move what they term the current 'consultations' to 'negotiations.' Each said they

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Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs to Julius Katz, Deputy USTR (31 March 1992): "As discussed on the phone I will be prepared to meet with you next week on the issue in Ottawa or Montreal when you are in Canada for the NAFTA Ministerial."

[527] Including the Departments of Energy, Commerce and State.

> hoped for some additional sign or signal of Canadian flexibility or responsiveness....[528]

To shift the process from, as US officials had suggested, consultations to negotiations, the USTR tabled a settlement proposal with Canada. Its terms did not differ substantially from what had been suggested by USTR officials Shoyer and Ruzika in their October 1991 meeting with a trade consultant to the BAC. It called on Canada to eliminate immediately all discriminatory pricing practices (differential mark-ups, cost of service charges, and minimum pricing requirements), shift minimum price to taxation, remove discriminatory distribution practices by 31 March 1993, and provide immediate access to all retail points of sale where domestic beer is sold, with the possible exception of brewpubs and micro-breweries.[529]

The only substantial differences in the proposal were that the US was now willing to acknowledge that Canada's brewers might need some transition time – to 31 March 1993 – to deal with distribution issues, and also that IPBs needed to be taken into consideration. However, Washington's position on IPBs was quite different from that taken by the EC in its earlier negotiations with Canada. While the US was willing to acknowledge, as the EC had, that Canada must eliminate its internal trade barriers to allow its domestic brewing industry to become competitive, as noted previously, Washington was not willing to follow the EC's lead that delay could come at the expense of its own producers. The US took the position instead that if IPBs were dismantled sooner than 31 March 1993, then the liberalization measures must also apply to the distribution of imported beers on the same schedule.[530] Consequently, US producers could only see an upside on timing if IPB reduction occurred before the barriers identified by the Beer 1 Panel Report were addressed.

Following a frenetic round of discussions with the Canadian industry and provincial officials, Canada's Deputy Minister for International Trade, Don Campbell, responded to the USTR proposal. As could be expected, Canada's rejoinder found the US proposal unacceptable, principally because it called for full implementation by the summer of 1992. Campbell counter-proposed that Canada was prepared to implement the changes affecting pricing and listing of US beers in the provincial systems by 30 June 1992. In addition, non-discriminatory access for imported beers to the distribution and retail outlets would be provided no later than 31 March 1995.[531]

As well, Deputy Minister Campbell addressed another matter that was causing increasing consternation amongst Canadian stakeholders – retaliation. Campbell noted the following in his letter to Julius Katz, Deputy USTR:

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[528] BAC memo (8 April 1992).

[529] 'Elements of a settlement concerning Canadian provincial beer marketing practices.' Document prepared by USTR as a basis for discussions with Canada to end Beer I. (10 April 1992).

[530] 'Elements of a settlement concerning Canadian provincial beer marketing practices.' Document prepared by USTR as a basis for discussions with Canada to end Beer I. (10 April 1992).

[531] Letter from Don Campbell, Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs to Julius Katz, Deputy USTR (13 April 1992).

> I wish to confirm that if you proceed to raise duties on Canadian beer exports today, Canada will announce a matching duty in imports of US beer into Canada effective today. If you announce that we are negotiating, but if these negotiations fail you will raise duties, we shall confirm that we are negotiating but announce that we too would raise duties effective the same date. Clearly, this is an action which I believe both we and our respective industries would wish to avoid. But retaliatory action by the United States without GATT authorization will leave us no choice.[532]

Canada's Trade Minister Michael Wilson reinforced this position during Question Period in Canada's House of Commons. In response to a question by New Democrat MP Dave Barrett of British Columbia – likely elicited by the lobbying of Canadian brewery worker unions - Minister Wilson was quoted by the BAC as saying that:

> ... [A]n offer has been put forward by Canada following consultations with the industry and the provinces. As for a threat of retaliation, Wilson said that if the US tries that Canada will take strong action in response.[533]

In answer to Canada's counter-proposal, the USTR published a news release on 14 April 1992 indicating that it would be prepared to delay retaliation and enter negotiations with Canada to end the beer dispute.[534]

A Deal is Reached

Surprisingly, at least to the Canadian stakeholder group, the US and Canada were soon able to reach a deal on the dispute. After a brief, but intense, period of negotiations lasting less than two weeks, Washington and Ottawa framed what came to be known as 'The Agreement in Principle. (AIP). The AIP was conditional on an overall settlement inclusive of termination of the US Section 301 action.

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[532] Letter from Don Campbell, Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs to Julius Katz, Deputy USTR (13 April 1992).

[533] BAC memo (10 April 1992).

[534] Deputy USTR Katz was quoted in the news release ('United States and Canada to hold negotiations on Canadian provincial beer practices.' USTR news release. (14 April 1992) to say that: "... '[T]he United States is delaying the imposition of increased duties on imports of Canadian beer so as to attempt to reach a negotiated resolution with Canada on the removal of discriminatory beer practices....' 'Although the Canadian response has been disappointing to date, we have decided to delay action for a short period of time in the hope that we can achieve a negotiated solution that will provide significant nondiscriminatory market access by this summer for US beer in Canada....'

In the AIP, Canada undertook to:

By June 30, 1992:

- Remove the general and administrative component of the cost of service in British Columbia, Alberta, Saskatchewan, and Ontario;
- Remove the differential mark-ups in New Brunswick and Newfoundland and on draught beer in British Columbia;
- Remove the prohibition on imported beer being sold in larger package sizes where that right is accorded to domestic products in Ontario;
- Undertake that the minimum pricing systems in British Columbia, Ontario, New Brunswick and Newfoundland will be in accordance with the Panel's recommendation that minimum prices not be set in relation to the prices at which domestic beer is supplied.

By September 30, 1993:

- Provide equivalent competitive opportunities to imported beer with respect to access to points of sale in British Columbia, Alberta, Manitoba, Ontario and Quebec.
- Provide equal opportunity to imported beer on delivery from an in-province warehouse to points of sale in the provinces of British Columbia, Alberta, Manitoba, Ontario, Quebec, New Brunswick, Nova Scotia and Newfoundland.

On receiving a written commitment from Canada on 25 April 1992, Acting USTR Julius Katz (serving after the departure of Carla Hills) acknowledged US acceptance of the AIP in a letter to Canadian Ambassador to the United States Derek Burney on the same day. In the letter, Katz acknowledged the AIP and proposed to restart negotiations no later than the week of 4 May 1992 to arrive at a full and final agreement that would be based on the AIPs terms.[535] He added that:

> It is my hope that the negotiations will be concluded as quickly as possible with a comprehensive agreement that will put an end to this long-standing problem.[536]

Lastly, Washington took measures to suggest that retaliation was no longer imminent. In a USTR news release published on 25 April 1992, Katz was quoted as saying that:

> … USTR will rescind its earlier instruction to the US Customs Service to withhold liquidation of duties on

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[535] Letter from Julius Katz, Deputy USTR to Don Campbell, Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs (25 April 1992).

[536] Letter from Julius Katz, Deputy USTR to Don Campbell, Canada's Deputy Minister for International Trade and Associate Under-Secretary of State for External Affairs (25 April 1992).

> Canadian beer entered, or withdrawn from warehouse for consumption, on or after April 13, 1992.[537]

All stakeholders appeared to be reasonably pleased with the deal. DFAIT was able to secure some significant movement by the provinces and the Canadian domestic industry with minimum rancour. DFAIT's hope was that the AIP would spark movement in the moribund federal-provincial IPB negotiations. For the US, while its industry was not totally satisfied that Canada had opened its market either wide or soon enough, the deal represented a significant step forward with a definitive timeline.

For the Canadian stakeholder group, things could have been far worse. While transition was not as long as the industry had hoped, the deal allowed the shelter of regulation for one more summer selling season, and the continuation of a number of the key principles girding the regulatory environment.[538] Moreover, it was achieved without having to endure retaliation.

The Ontario Reaction

Though the public statements of the industry suggested that Canada's brewers were pleased with the AIP, a large part of this acceptance was rooted in an appreciation that the impact of the deal could be mitigated significantly by the implementation choices each province now selected. The BAC began to lobby individual provinces to assure that they complied with the letter of the AIP, and nothing more. The primary target was the new NDP (New Democratic Party) government of Bob Rae in Ontario.

Representing the lion's share of profitability in the Canadian beer market, outside of Quebec, and governed by a party not known for its support of measures taken by Ottawa to appease the United States, Ontario was regarded as the optimal choice to blunt the actual commercial impact of the AIP. The primary focus of brewers in this lobbying effort was assuring that regulatory limitations were placed on US one-way aluminum beer containers.

Canada's brewers believed that if US importers could be penalized via taxation measures for using aluminum cans, Canadian domestic brewers could compete effectively with bottles in Ontario. The bottle was over 90% of the Ontario beer market, and it was the low-cost package for Canadian brewers. Moreover, there was confidence amongst both Ontario government trade experts and the BAC's trade consultants that such a measure was consistent with the GATT as it had an environmental purpose.[539]

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[537] USTR news release "United States and Canada reach agreement in principle on removal of discriminatory Canadian provincial beer practices.' (25 April 1992).

[538] The BAC released a public statement on the deal (BAC statement on the AIP. (24 April 1992) saying that: "We are not overjoyed with the 18 month transition period, but we are pleased that the two countries have been able to reach a negotiated settlement of the trade dispute. The position of the industry has been that we need transition time to allow the necessary adjustments to increased competition from the United States. Obviously, a reduction in the transition period will mean that the brewing industry will have a more difficult time making those adjustments."

With the above as its rationale, Ontario announced in a budget measure on 30 April 1992 that it was increasing its environmental levy from five cents to ten cents on all non-refillable beverage alcohol containers effective 25 May 1992. In order to buttress the trade defensibility of the measure, Ontario also applied it to domestic beer containers that had not been captured by the levy.

The timing of the measure by Ontario was unfortunate. Coming as it did before the AIP could be evolved into a final agreement to end Beer I, the US immediately distanced itself from the accord and protested Ontario's actions.

Sensing that perhaps it had moved too aggressively, Ontario developed a hurried response to the US protests, suggesting that an 'interim system' for container returns might be established to cushion the impact of the new levy. However, by that point, Washington had seen enough. Deputy Assistant USTR for North American Affairs, David Weiss, wrote DFAIT's Doug Waddell to protest Ontario's actions:

> We remain deeply concerned about Ontario's announced tax, which is set to be imposed as of May 23, 1992 [sic]. The tax constitutes yet another discriminatory practice against US brewers. Its imposition following a GATT panel report that found many of Ontario's other practices in regard to the pricing, distribution, and marketing of imported beer to be inconsistent with Canada's GATT obligations, and following the signing of an agreement in principle and the beginning of negotiations toward a final agreement on the Beer I case, raises a serious question whether the province of Ontario is determined, in one way or another, to frustrate the entry of imported beer. While Ontario professes to be motivated by environmental concerns, the fact that the tax would be applied to cans containing beer, rather than all other non-alcoholic canned products, makes it evident that the primary motivation is to create a further barrier to trade. This

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[539] As a BAC trade consultant noted in an interview for this dissertation (Dissertation interview): "We genuinely regarded the bottle as a legitimate conservation measure designed to deplete waste in landfills. The 'Blue Box' [Ontario's curbside waste diversion system] was a scam. It didn't work. It cost municipalities more as it allowed soft drinks to avoid the true costs of managing their containers." However, a former USTR official also interviewed disagreed (Dissertation interview): "The environmental levy was clearly an impediment to trade. For example, we were able to show that beer bottle caps generated by Canadian brewers actually caused more waste than all of the US beer cans exported to Canada. Our view was that the US system was just as effective on the environment, and it didn't present the same level of discrimination."

> matter thus threatens to become a major element hindering further progress in the negotiations.[540]

Weiss went on in his letter to announce that, unless the Government of Canada intervened to forestall the new Ontario environmental levy, the US was contemplating suspending its negotiations with Canada and retaliating.[541]

There was little chance that a socialist NDP government was going to be seen to back down either to Ottawa Tories or Washington Republicans. While the Rae government did try to soften the blow of the tax via other concessions, it would not rescind it.[542]

The US Retaliates

Though officials from Canada and the US continued to meet through the end of June 1992 and on into July 1992, they were only going through the motions. It was clear that the US would request authorization to retaliate at the first available opportunity with GATT Council. It did so at the GATT Council on 14 July 1992.

Following an aggressive US presentation, [543] Canada's representative to the Council – again, Pierre Gosselin - mounted a spirited defence, suggesting that Canada had taken significant steps to bring its practices into compliance with the GATT. He also pointed out that the US had not advised the Council in advance of what specific actions it was now proposing to take. Therefore, the Council had no basis to authorize US action at that particular meeting.[544]

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[540] Letter from David Weiss, Deputy Assistant USTR for North American Affairs to Doug Waddell, DFAIT's Director-General, Trade Agreements Bureau. (14 May 1992).

[541] Letter from David Weiss, Deputy Assistant USTR for North American Affairs to Doug Waddell, DFAIT's Director-General, Trade Agreements Bureau. (14 May 1992).

[542] For example, on 19 June 1992, the Ontario government – much to the chagrin of the Canadian industry – announced that it would be accelerating access for foreign brewers to the Brewers Retail network. In a news release on 19 June 1992 (Ontario Ministry of Consumer and Commercial Relations news release 'Ontario accelerating foreign brewers access to beer stores.' 19 June 1992) Ontario Minister of Consumer and Commercial Relations, Marilyn Churley announced that "… Ontario will accelerate foreign brewers' access to the province's beer stores. Ms. Churley said Ontario would expedite the removal of remaining international barriers to trade in beer. 'Ontario is making every effort to help conclude the trade negotiations with the US. We are making a significant move by giving foreign brewers access to our beer stores before the deadline agreed to with the United States,' said Minister Churley. She said she would be introducing the necessary legislation during the fall session of the Ontario Legislature and would make every effort to secure parliamentary approval for the legislation. This would allow foreign brewers access to Ontario's Beer Stores, a cooperative owned and operated by Ontario brewers, in time for the summer of 1993."

[543] The US submission is referenced in a Bloomberg News report that appeared after the Council session (Bloomberg News Service 14 July 1992): "In the latest twist in a long-running row over beer, the US threatened to retaliate against Canada for allegedly unfair restrictions on US imports. At a regular council session of the GATT, US Deputy Trade Representative Rufus Yerxa officially sought permission for the US to withdraw trade concessions worth about $80 million a year from Canada. Washington estimates this is the value of trade lost by US companies. His request was blocked by Canada, which described it as 'unwarranted', according to a source present at the closed session…. Yerxa said Canada had failed to implement the report of a GATT arbitration panel, which last year found that Canadian provincial liquor board controls on the distribution of beer violated GATT rules. Yerxa charged that an environmental tax on beer cans increased the discrimination, because US exporters more than Canadian producers, use cans."

Gosselin went on to remind the Council that at its last meeting Canada had advised the Contracting Parties that, following bilateral consultations, Canada and the United States had reached an agreement in principle on implementation of the Panel's rulings. The AIP stipulated that measures on pricing and listing would be implemented by 30 June 1992 and on access to points of sale by 30 September 1993. He noted that this undertaking entailed compliance with the Panel decision some 18 months sooner than envisioned in Canada's previous communication to Contracting Parties on 30 March 1992.[545]

Gosselin concluded his presentation by noting that Canada considered its response to the Panel Report to be comprehensive and impressive in terms of meeting its obligations under the GATT. He then closed by invoking the *bete noire* of all US trading partners to explain why Washington remained recalcitrant – Section 301:

> Why then are we hearing arguments from the US, Mr. Chairman? It would appear that it is because we have not made changes in a way, which satisfies US brewers that the US feels compelled to make its unwarranted request of this Council. It pure and simply appears to us that the US industry is much more interested in having the US exercise its big stick – Section 301 – than it is in getting down to business and accepting our right to act in accordance with our GATT obligations.[546]

GATT Council did not approve the US request.[547] However, this barely slowed Washington's rush to announce its withdrawal of concessions from Canada, which occurred on 23 July 1992.

The result of this retaliatory strike was that the US immediately increased duties of fifty-percent *ad valorem* (value added) on imports of Canadian beer brewed or bottled in Ontario. As part of the action, the US Customs Service was also instructed by the USTR to monitor imports of beer from other Canadian provinces, including Quebec, and regularly report on the data gathered. If Ontario imports were found to have surged significantly beyond historical trade levels, which would suggest diversion or circumvention of trade from Ontario, then the US indicated that it would then expand the imposition of the fifty- percent *ad valorem* duty to imported beer brewed or bottled in the province in question.[548]

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[544] Notes for Canada's oral statement to the GATT Council. (14 July 1992)
[545] Notes for Canada's oral statement to the GATT Council. (14 July 1992)
[546] Notes for Canada's oral statement to the GATT Council. (14 July 1992)
[547] The US request was opposed by Canada, the EC and the Nordic countries.

The same day, as it had promised it would do on a number of occasions, Ottawa announced counter-retaliation. Trade Minister Michael Wilson declared that Canada would impose a matching duty of fifty-percent on some imports of US beer into Ontario. In an interesting twist, the Canadian duty applied only to beer from Heileman and Stroh, and would not be implemented for beer imported into the other provinces. The impact was expected to be at least 65 cents for a six-pack of beer.[549] Other US beer imports into Ontario were not to be affected.

While on its face, it may appear that – not unlike the scenario described by Barbara Tuchman in the Guns of August - Canada and the US had stumbled unwittingly into a nightmare for all stakeholders, something very clever and calculated – and possibly, coordinated - had actually taken place.

If it had wanted to, either the United States or Canada could have chosen to play a dominating strategy at this juncture. There were ample reasons in terms of international political stature for Ottawa and Washington to proceed down that road. The United States had been backed and filled by Ottawa and the provinces at every juncture, including being compelled to launch a second GATT Panel challenge to secure what USTR officials felt had been won by the 1988 EC Panel Report. And, Canada was now the target of retaliation, even though the United States had sought GATT authorization and failed. Surely, there were enough political chips on the table for either side to contemplate upping the ante to secure a settlement on its own terms. The worst that could come of it, particularly for the United States, might be that it would add to its reputation for toughness in managing international trade disputes.

However, it is key that neither side sought to increase its wager beyond the chips already played. The retaliation by both parties was targeted to such a degree that it was unlikely to escalate uncontrollably or affect other trade files.[550] The only Canadian products affected were those brewed in Ontario. The only US brewers that suffered increased duties were those with a specific interest in the dispute.[551]

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[548] USTR news release 'US to increase duties on Ontario beer.' (23 July 1992).

[549] DFAIT news release 'Canada responds in kind to US retaliation on Ontario beer.' (24 July 1992).

[550] The level of retaliation was credible in a proportionality sense. As a USTR official interviewed for this dissertation noted (Dissertation interview): "Because we were only dealing with Stroh and Heileman, there was a need to have credible numbers. The retaliation sought had to be credible with the harm – and we felt limited by the GATT rules in this regard."

[551] As a senior DFAIT official interviewed for this dissertation suggested, (Dissertation interview): "We hit Stroh and Heileman for strategic reasons. We felt that it would divide the US industry and separate the big guys from these two smaller players. Moreover, Stroh brought the complaint so we targeted them directly."

Additionally, Ontario was isolated as the recalcitrant party[552] – and all other provinces were presented with a reason not to protest lest they be next in line.[553] Further, the US brewers who had launched the dispute – Heileman and Stroh – were at the time becoming even more financially desperate and needed the growth that only access to the Ontario market could yield. To have it suddenly attenuated was a terrific incentive for them to try to find a way out of the impasse.

A further consideration for DFAIT decision-makers was that although Canadian brewers would not be irreparably harmed by the $80 million impact of retaliation, particularly given that open access by US brewers to the Ontario marketplace would probably cost Canada's brewers significantly more, it was felt to be enough to provide them with an incentive to settle. This was because Ottawa understood that both Molson and Labatt regarded the US as offering growth potential that they could not find in the stagnant Canadian market.[554]

With all of these elements in play, the best course ahead for Washington and Ottawa was to wait for the pressure for a settlement to build.

Searching for a Settlement

The first parties to move to settle the dispute were Canada's brewers and the province of Ontario in the fall of 1992. They jointly presented options to Canada's federal government for how a third-party managed arbitration process – either within GATT or the CUSTA - could work.[555]

Canada presented its arbitration proposal to the US over a series of meetings during the fall of 1992. However, with the summer selling season having passed, there was no real incentive for the US industry to press the USTR to take Canada up on its offer. In fact, trade consultant reports to the BAC indicated that the US industry wanted:

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[552] Trade Minister Wilson publicly excoriated Ontario for triggering the US retaliation. His views were quoted in a CBC television report (CBC World at Six 23 July 1992): [Reporter]: This means putting new duties on American beer coming into Canada. The federal trade minister, Michael Wilson, says that's a possibility. Still, he doesn't make any secret of the fact that he blames Ontario for the problems Canada has had in finalizing the deal agreed to in April. [Wilson] "Since then there have been a number of actions taken primarily by the province of Ontario which have thrown that agreement in principle pretty well out of the ballpark." A senior DFAIT official interviewed for this dissertation intimated another reason that only Ontario was targeted by the US (Dissertation interview): "The US did not go after Quebec for wider political reasons – and, the USTR was really upset mostly with Ontario. It is important to keep in mind that national unity is an important consideration for the US in its bilateral relationship with Canada."

[553] Ontario continued to play its part as the villain for the US. For example, Minister Churley made the following statement on 24 July 1992 (Statement by the Ontario Minister of Consumer and Commercial Relations 24 July 1992): "The Ontario government fully supports and endorses Ottawa's counter-measure. The Canadian action is consistent with Ontario's approach to international trade negotiations of 'playing by the rules.' On the other hand, the US is acting like an international trade outlaw. The US harassment is completely unnecessary. It is very harmful to both countries."

[554] In fact, Molson had presented detailed information to DFAIT showing that it had great hopes for growing in the United States.

[555] BAC memo (2 October 1992).

> . . . [T]he Canadian side to bleed for awhile; they do not believe the Canadians will negotiate seriously until the pain is more acute. To do otherwise would ensure the Canadians continue to play their games. The US believes that Canada will not get on with it 'until there is blood on the floor.'[556]

Canada took the additional step of bringing the arbitration proposal to GATT Council on 29 September 1992. The US rejected Canada's request in that forum as well.

The US was not interested in bringing the dispute to a 'rules-based' process for neutral arbitration. This is not surprising given that USTR negotiators knew they had more of an opportunity to shape a favourable outcome in face-to-face, commercially focused talks with Canada.

The US spelled out this preference during a meeting with DFAIT officials on 25 November 1992.[557] Deputy USTR Julius Katz further reinforced it in a media teleconference on 16 December 1992. During the teleconference, Katz indicated that if a settlement was going to be reached, it could only be via bilateral negotiations with Canada.[558]

As the dispute continued, Canadian brewers endured retaliation – though consumers of Canadian beers in the US did not. Usually, when duties are charged to a product, they are passed on to consumers in the form of higher prices. Consequently, the producer is penalized twice – once by the government in the form of duties, and a second time by the marketplace as the producer is unable to price its products competitively.

However, in the case of the US retaliatory duties, both Molson and Labatt chose to absorb the increased duties to mitigate the potential for market share loss in the US. Losing market share would have been a more severe sanction to Molson and Labatt given the level of investment required to grow both businesses back to their pre-retaliation levels.

The same option was not available to US brewers. Both Heileman and Stroh were in increasingly precarious financial straits. Consequently, absorbing Canadian retaliatory duties was not a viable course. Moreover, the new Ontario minimum-pricing regime would not permit US brewers to drop prices to the level required to compete effectively against Canadian brewers. Therefore, both companies suffered market share losses.

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[556] BAC memo (22 September 1992).
[557] BAC memo (25 November 1992).
[558] BAC memo (16 December 1992).

In addition to the financial strain that retaliation was placing on breweries[559] both north and south of the border,[560] Washington and Ottawa were also growing weary of the continuing melodrama on beer. Much of this was driven by winds of political change beginning to blow in both capitols.

Canadian Prime Minister Brian Mulroney was languishing in the polls and would soon announce his departure from political life. Kim Campbell would replace him as leader of Canada's Progressive-Conservative Party on 13 June 1993, and then as Prime Minister on 25 June 1993. In the United States, Bill Clinton succeeded George Bush after besting him in the 1992 presidential campaign. Both Prime Minister Campbell and President Clinton showed an interest early on in their mandates in jettisoning the trade dispute baggage of their predecessors. This would mark a significant change in the tenor of the beer disputes – and also in the influence of the DFAIT-USTR epistemic community on events.

The first evidence of a changing dynamic in the beer disputes came on 10 March 1993 when Mickey Kantor, the new USTR appointed by President Bill Clinton, wrote Canadian Trade Minister Michael Wilson to propose rekindling the negotiations on beer.

> You will recall that both Secretary Brown and I raised the beer issue with you during our meetings in Washington on February 8, 1993. As a follow-up to those meetings, I believe it would be useful for us to explore means to break the current impasse in the dispute. Both our governments now have in place retaliatory duties, yet it does not appear that appropriate efforts are being made to find a resolution to the dispute. The retaliatory duties have therefore become the status quo, a situation that neither of us should find acceptable.[561]

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[559] Canadian brewers were also rumoured to be shipping Ontario-brewed product through other provinces to help mitigate the impact of the US duties. In a letter to Trade Minister Michael Wilson, Mickey Kantor (Letter from USTR Mickey Kantor to Trade Minister Michael Wilson. 10 March 1993) noted that: "US brewers are now alleging that circumvention of the duties, through a shift in the relative composition in imports from Ontario and Quebec, is taking place. These allegations are being investigated. More importantly, analysis based on data compiled by the US Customs Service indicates that, to date, the retaliatory duties have been ineffective in offsetting the damages to US exporters as a result of Ontario's discriminatory practices."

[560] The issue of financial impact on the Canadian industry was addressed by BAC President Dan Gagnier in comments to the media (New York Times. 6 August 1993): "To preserve their share of the American market, Canadian breweries and their American bottlers have avoided raising prices and paid at least $3 million a month in taxes out of their profits…."

[561] Letter from USTR Mickey Kantor to Canadian Trade Minister Michael Wilson (10 March 1993).

USTR Kantor went on in his letter to offer to recommence bilateral negotiations – an approach that had been continually resisted by Canada. However, in suggesting a bilateral forum, Kantor also indicated that the US would be looking for practical solutions to commercial issues, and that Washington was prepared to perhaps be more flexible.[562]

Trade Minister Wilson responded a week later.[563] Canada stood fast – at least rhetorically – on its proposed arbitration solution. However, it is important to note that this commitment to binding arbitration was not DFAIT's preferred position. Rather, Ontario and Canada's brewers were insistent on Canada continuing to advance this view.

As at many other times during the beer disputes where DFAIT differed with Ontario or one of the other Canadian stakeholders, it simply stepped aside and became the conduit for the alternative position to be conveyed to the US. There was no need for Ottawa to disagree – Washington would do it soon enough.

Wilson also took the opportunity in his letter to open a crack in Canada's position by suggesting that Ottawa was interested in receiving more details on how the US saw bilateral negotiations proceeding. Wilson concluded by putting an additional twist on the potential for bilateral discussions. For the first time, he suggested that any proposal that Ottawa might entertain had to be acceptable to Ontario as well.[564]

While Ottawa's concern for Ontario may have appeared to be a positive development to Queen's Park, it was anything but. By suggesting to Washington that Ontario held an effective veto for Canada in the negotiations, DFAIT was signaling to the USTR that it did not necessarily support the positions that were being brought forward. Additionally, emphasizing that Ontario was the force behind Canada's intransigence had the effect of playing into the growing animosity USTR officials felt for Ontario in the disputes. Lastly, in terms of managing its domestic political position, emphasizing the prominence of Ontario in discussions presented a significant opportunity for DFAIT to deflect any blame for failure. If this newest attempt at settlement foundered, it would not be Ottawa's issue – it could be laid plainly at the doorstep of Bob Rae's New Democrats.[565]

The USTR at this stage had little to lose in pressing forward, especially since Canada had quietly dropped its insistence on arbitration. Consequently, USTR officials communicated to DFAIT that Washington would be willing to recommence negotiations. Sessions were scheduled for 20-21 May 1993 in Washington.

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[562] Letter from USTR Mickey Kantor to Canadian Trade Minister Michael Wilson (10 March 1993).

[563] Letter from Trade Minister Michael Wilson to USTR Mickey Kantor. (18 March 1993).

[564] Letter from Trade Minister Michael Wilson to USTR Mickey Kantor. (18 March 1993).

[565] Wilson articulated this view in his letter to Kantor (Letter from Trade Minister Michael Wilson to USTR Mickey Kantor. 18 March 1993): "Regardless of the approach taken, the cooperation of Ontario is necessary for any settlement to be implemented. In the absence of a rules-based arbitration, we would need to be creative in finding any approach acceptable to all sides. I would be interested, therefore, to receive further details of the negotiations you are proposing. Elaboration of the process and agenda you envisage would allow us to gauge whether the process might succeed and to take your proposal to Ontario for thorough discussion."

The Negotiations Begin

Ottawa remained in the mode of helpful messenger between Washington and Queen's Park in the preparations leading up to the May meetings. For the most part, DFAIT permitted Ontario to dictate the terms of Canada's opening position. In developing its point of view, Ontario relied heavily on advice and counsel from Molson and Labatt, who were then communicating regularly with Stroh in an effort to broker a 'commercial' settlement.[566]

Interestingly, the USTR had also begun to operate in a similar fashion to DFAIT in terms of managing its relations with Stroh and Heileman. Both agencies had grown weary of the dispute and were searching for a resolution that could be reached quickly and that revised provincial liquor board regulations to the extent that both Washington and Ottawa could claim victory.

Canada opened the 21 May 1993 session by offering a comprehensive package of amendments to Ontario's liquor regulations. The offer included: access for foreign brewers to Brewers Retail (BRI) by mid-July 1993; a lowering of BRI service fees to $0.51 per litre for imported beer, as well as an annual fee adjustment that would be tied to the CPI (Consumer Price Index); profit-rebates to BRI non-shareholders (the shareholders were Labatt and Molson) triggered by sales volumes; a lowering of the LCBO out-of-store cost of service charge to $0.25 per litre (or $2.13 per case of 24 cans), with the self-delivery cost of service lowered to $0.188 per litre (or $1.60 per case of 24 cans); a freezing of the minimum price at current rates of $2.75 per litre (or $26.00 per case of 24 cans) until December 31, 1994, as well as an undertaking that future adjustments would not exceed growth in the annual Consumer Price Index (CPI). However, noticeably absent from Canada's offer was any form of concession on the issue that had scuttled the Agreement in Principle and led to retaliation – the environmental levy.

While the United States was disappointed that Canada's offer featured no movement on the environmental levy, there appeared to be enough on the table for USTR officials to stay engaged in discussions with DFAIT. Position papers began to be passed back and forth between the two parties in a whirl of activity that would go on for the next two days.

The actual logistics of the negotiations would have appeared odd to any outside observer. While the 'in-the-room' sessions involved representatives from DFAIT and USTR as the 'official' negotiators,[567] the positions they exchanged were actually designed, debated and weighed by parties outside the room. For Canada, the Government of Ontario and Canada's brewers held the pen. For the US, it was Heileman and Stroh.

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[566] Throughout the entire period of the negotiations that led to a settlement, Molson's Barry Joslin was in contact with Chris Sortwell of Stroh. This became one of the key conduits for resolving the dispute as both DFAIT and USTR stepped back to operate as quasi-agents for their respective industries (Dissertation interviews).

While the actual negotiations quit on 21 May 1993, discussions between the parties continued on a number of fronts into June 1993. The dynamic of these interactions was similar to that of the actual negotiations. The USTR played the part of impatient *demandeur* on behalf of the US brewers, pressing Canada to secure movement, and DFAIT officials returned to Ontario and Canada's brewers to inform them that whatever was on the table was insufficient to secure a deal. To lend urgency to the deliberations of the Canadian stakeholder group, DFAIT officials would add that their USTR colleagues had informed them that Washington was considering increasing the level of retaliation against Canadian beer.

By mid-June 1993, the parameters of a deal to end Beer 1 began to take shape. After a meeting between the BAC's trade consultants and USTR officials on 23 June 1993, it became clear that the US would be prepared to settle as long as it could secure Canada's commitment to ensure that all other provinces would abide by the Beer 1 Panel Report, that Quebec would not implement a minimum price regime and also agree to deal with a number of warehousing issues, that the BC minimum price model would be amended to be similar to Ontario's, and that "... any future environmental measure not prejudice US export interests...," [568] which suggested acceptance of Ontario's environmental levy.

Following a number of false starts and ongoing threats of retaliation by the US, Washington and Ottawa closed on a compromise. An important fillip to the process was a widening rift in the solidarity of Canada's brewers. As Molson was partially owned by US brewer Miller Brewing Company, which no doubt was concerned about the potential impact of Beer II on US wholesaling regulations, as well as the negative effect of retaliation on its ability to grow Molson's portfolio in the US, it began to press both Ottawa and Queen's Park to settle. Labatt resisted Molson's settlement efforts, particularly as it related to Ontario offering any more concessions on minimum price.

However, it was clear that Ottawa, and now Ontario, were tiring of the continuing fight with the US. The trade dispute was a growing sump for resources and a distraction from larger issues on the bilateral agenda with Washington.

Moreover, the two new political administrations in Washington and Ottawa were anxious to end the rift. Unlike their predecessors who were content to allow DFAIT and USTR officials to manage the dispute, both Prime Minister Campbell and President Clinton pressed their trade bureaucrats to settle.

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[567] Though, on occasion, experts of the Ontario government were also called into the sessions to explain the intricacies and impacts of the offers that it was making.
[568] BAC memo (23 June 1993).

However, there was some resistance from officials at the USTR who remained concerned about Ontario's environmental levy and officials at DFAIT who believed more needed to be done to remove provincial regulatory protection for Canada's brewers.

A US official interviewed for this dissertation reports that there was a discussion in Washington on the eve of the US weighing the decision to increase the level of retaliation or settle that left no doubt as to what choice would be made. It was clear that the US was going to step up the pressure on Canada by increasing the duties on Canadian beer imports. However, events at the Group of Seven Summit Meeting in Tokyo intervened to change the course of the dispute.

> I ... [a US official] ... met with USTR [Mickey] Kantor before the Tokyo summit in July 1993. He instructed me that we should prepare to increase our retaliation against Canada because Ontario wasn't going to move on the levy. He then went to the Tokyo summit and attended a meeting between Prime Minister Campbell and the President. When he returned to Washington his instructions to us were to get the deal done.[569]

The Tokyo Summit meeting of Prime Minister Campbell and President Clinton was the key moment that brought the dispute to an end. At their Tokyo session, Prime Minister Campbell, facing an election campaign with the Canadian economy in a significant downturn, suggested to President Clinton that she did not want to exacerbate the growing criticism being directed at the Tories for having entered the CUSTA. The beer dispute held little importance for either administration yet had the potential to become a political issue, especially if the US increased its level of retaliation against Canada. Would he consider settling the dispute? President Clinton agreed and instructed USTR Kantor to enter a Memorandum of Understanding (MOU) with Canada to end Beer 1.[570]

The Memorandum of Understanding (MOU)

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[569] Dissertation interview. This story was also corroborated by media reports. The Financial Post first reported it on 22 July 1993, followed by the Wall Street Journal and Inside US Trade on 6 August 1993. Inside US Trade (6 August 1993) described the impact that Prime Minister Campbell and President Clinton had on the negotiations in the following passage: "The Administration had appeared to be moving towards further retaliation against Canada in the dispute earlier this year, but sources say that a high-level deal was worked out between President Clinton and Canadian Prime Minister Kim Campbell during the Group of Seven summit meeting in Tokyo in early July. Following that meeting, US negotiators dropped their opposition to Ontario's environmental levy, and began work to conclude the deal on the basis of a mid-June offer by Ontario to cut its minimum price, lower service charges, and open access for US beers in the BRI outlets."

[570] A number of dissertation interviews of USTR and DFAIT staff confirm that Prime Minister Campbell initiated the discussion and asked for a settlement.

The MOU between the United States and Canada was framed on 5 August 1993. *Inter alia*, it enumerated minimum retail prices based on alcohol content and specified how they were to be increased over time; required that any new measures or changes to existing terms pertaining to the importation, distribution, sale or pricing of beer be consistent with the MOU, and with GATT law as interpreted by the Beer 1 Panel Report; set limits on various service fees imposed on brewers by Brewers Retailing and increased the fees that were then in effect. Based on these undertakings, Canada and the US agreed to withdraw retaliatory duties.

The terms of the MOU demonstrated significant compromise by both Canada and the US on positions that each had held for close to a year. Canada assented to modifying the minimum price policy in Ontario to link it to alcohol content,[571] to permitting immediate access to the Brewers Retail network and to lowering a number of cost-of-service charges at the LCBO.

The US made even greater concessions to bridge the gap to a final deal. Washington acceded to the Canadian provinces implementing minimum prices – as long as they were not set in relation to domestic products – quietly assented to Ontario's environmental levy, and withdrew a longstanding demand for a provincial standstill on implementation of new regulatory policies governing the marketing, distribution and sale of beer.[572]

It is important to note that the US also put Canada on notice that the MOU did not mean that it was offering *'carte blanche'* to the provinces on their practices going forward. The USTR news release announcing the MOU stated pointedly that:

> "…[T]he MOU also allows the United States, following consultations with Canada, to terminate the agreement on 30 days notice should the United States consider that any new measure, including discriminatory tax arrangements or minimum price

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[571] The MOU stated that "Effective the first Monday following coming into effect of this MOU, Ontario's minimum retail price for beer, exclusive of the environmental levy and applicable container deposit, will be no higher than:

Alcohol content (by volume)	Minimum retail price (per litre)
Less than 4.1%	C$ 2.49
Greater or equal to 4.1% but less than 4.9%	C$ 2.53
Greater or equal than 4.90%	C$ 2.60

The minimum price may be adjusted annually by no more than the provincial consumer price index (CPI), based on the most recent 12-month period for which data from Statistics Canada are available."

[572] The MOU contained the following language (Memorandum of Understanding 1993): "Canadian competent authorities reserve the right to introduce or modify measures or practices pertaining to the importation, distribution, sale or pricing of beer, but may not introduce or modify any such measures or practices in a manner that is inconsistent with Canada's obligations under this MOU or under the GATT, including the obligations of national treatment and the GATT Panel report of 18 September 1991…."

> requirements, or modification of an existing measure materially impairs its terms of access. 'For this agreement to remain effective, it must ensure against future discrimination against US brewers of the nature that we have seen in the past', Ambassador [Mickey] Kantor said. 'This is why the termination clause is important, and I want to emphasize that we will not hesitate to use it if warranted.'"[573]

The tone of the news release suggests that there was probably some residual resentment at USTR for how the deal was done, and likely significant trepidation about how the provinces would behave in the post-MOU environment.

The US Industry Reacts

It was now the turn of the US brewers to be appalled by the terms of a deal negotiated by their federal government.[574] Heileman was particularly exercised.[575] The Lacrosse, Wisconsin-based brewer published a news release on 12 August 1993 denouncing the deal.[576]

Heileman's objection was that the USTR had agreed to accept many of the most trade inconsistent provincial practices identified by the Beer 1 Panel Report. Heileman noted in its news release that:

> Our Government caved in to pressure from Canada, and the result is the continuation of unfair barriers to

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[573] USTR news release. 'United States and Canada reach settlement in beer trade dispute.' (5 August 1993).

[574] A US industry official was quoted in Inside US Trade (6 August 1993) as saying that: "... the Administration has backed down on an issue where it would have been much more effective to stick to a tougher line. 'If there ever was a case where the US is in the right and the trading partner is in the wrong, it is beer with Canada', he said. 'We just don't have the guts to do what we ought to do.'"

[575] Stroh's reaction to the deal was more positive, principally because it was one of the main architects of its commercial terms. The Wall Street Journal (6 August 1993) reported that: "Detroit-based Stroh Brewery Co., one of the US brewers that led the fight for greater access to Canada's beer market, gave the accord a tepid review. The pact is 'reasonable,' said Chris Sortwell, a Stroh vice-president. 'The real issue is going to be how it gets implemented.'" Sortwell's comment was reported more positively by Inside US Trade (6 August 1993) which suggested that Stroh "strongly supports" the deal. The Journal of Commerce (6 August 1993) reported that: "The pact does not address a 10-cent-a-beer can tax that Ontario claims is intended to encourage the use of glass bottles as an environmental goal. US trade officials said the tax was a disguised barrier to American beer, most of which is sold in cans. Large American brewers like Anheuser-Busch Cos. are worried that the can tax will be copied in other provinces and in other countries."

[576] Heileman's news release (Heileman news release 12 August 1993) denounced the deal explicitly: "We understand that the Governments of the United States and Canada have reached an agreement that purports to settle a dispute on limits on access of US produced beer into Canada. The agreement precludes US brewers from enjoying the same market access to Canada that Canadian brewers enjoy in the United States. We strongly object to this result and regret the US government was unable to obtain the removal of discriminatory barriers to trade."

> American products. Heileman pursued trade relief properly through the prescribed channels – US law and international agreements. We won a decision that called for an end to discriminatory barriers. Through this agreement, we face new barriers, which effectively limit our access, particularly to Ontario, and we cannot yet know if access to Quebec will be allowed or access to British Columbia will be restored. This is no victory.[577]

As Heileman suggested in its news release, it was too soon to tell how events would evolve in British Columbia and Quebec. However, the situation would be clarified quickly enough.

Interpreting the MOU as affirming the rights of provinces to adopt minimum price regimes as well as a number of other regulatory changes, Quebec moved quickly to implement its own minimum price protocol.[578]

On learning of Quebec's new minimum price policy, US brewers protested to the USTR demanding that the MOU be scuttled and the case against Canada be re-opened. This time not just Stroh and Heileman were involved. Anheuser-Busch finally stepped out of the shadows and voiced its opposition to the MOU publicly.

That all three brewers set aside their varying interpretations of the benefits of the MOU was a significant change in the political dynamic of the dispute settlement process.[579] While Stroh and Heileman could be dismissed as financial disasters, Anheuser-Busch was the US industry leader and a political heavyweight. Consequently, it appeared to observers that the MOU could be in jeopardy.

On 12 December 1993, Anheuser-Busch, Stroh and Heileman wrote the USTR to denounce the MOU and urge that the US border be closed to Canadian beer:

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[577] Heileman news release (12 August 1993).

[578] Quebec was not alone in its interpretation. In reporting on the MOU, the Wall Street Journal (6 August 1993) made the following judgment: "The agreement allows other provinces to introduce minimum price rules, environmental taxes and other measures similar to those secured by Ontario. In return, the US has the right to terminate the agreement within 30 days if it considers any new moves by the provinces discriminatory."

[579] In their letter to Mickey Kantor (Letter from Anheuser-Busch, Heileman and Stroh to USTR Mickey Kantor. 12 December 1993), the three brewers discussed the dynamic that caused them to join forces: "As you will recall, there was a division within the US industry about the merits of the MOU. Anheuser-Busch and Heileman were convinced that the MOU would not succeed in opening markets for American beer. Stroh believed that there could be a light at the end of the tunnel. In the final analysis, the passage of time has shown that Stroh's optimism was unwarranted. Now, we three brewers are united in our belief that the clear unwillingness of the Canadian provincial authorities to implement the implicit and explicit promises makes it highly unlikely that we will be able to compete fairly in Canada."

> We ask further assistance in moving this matter to a resolution. From our survey, province-by-province, we believe that it is apparent that the 'resolution' of the Beer War by means of the MOU is a mere fiction. Are we worse off today than we were four years ago? The answer is an unfortunate, but unequivocal, 'yes'. And it was four years ago that the Section 301 action was prepared to try and end the discriminatory treatment that we were experiencing at the time. While further jaw-boning may work to break some deadlocks, this problem is simply not susceptible to that form of cure. There is systematic discrimination which will never permit imported beer to compete on an equal basis with Canadian-brewed beer. If the Canadians want it both ways, we have reluctantly concluded it must be with both barrels. We ask, therefore, that you deliver a very simple message. Either all of the restrictive Canadian practices and the mindset against meaningful competition with imported beer are eliminated, or the entire border should be closed to all beers brewed in Canadian provinces other than Alberta.[580]

While some officials at USTR appeared willing to take up the fight again, there was no will at the senior political level of the Clinton administration to press the case to the point of recommencing retaliation against Canada.[581] As a Canadian brewing industry official interviewed for this dissertation noted:

> The Anheuser-Busch intervention, which was the only real news here, came too late in the day to have any real impact. Both the US and Canada felt that they had a reasonable deal. Moreover, Anheuser-Busch had a very lucrative licensing deal with Labatt in Canada that affected its credibility. Lastly, it is important to keep in mind that Anheuser-Busch's intervention was really more of a reaction by its

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[580] Letter from Anheuser-Busch, Heileman and Stroh to Mickey Kantor, USTR. (12 December 1993).

[581] Dan Gagnier, President of the BAC, wrote RA Kilpatrick of DFAIT to protest new moves by USTR staff to press the case against Canada (December 7, 1993): "I am concerned that the United States appears to be trying to reopen the negotiations of the Beer I dispute. The most recent examples are the letters from David Weiss and Rufus Yerxa, who appear to have taken the view that the MOU is whatever they believe it should be and that Canada should be prepared to change provisions with which they disagree…. The United States has offered the view that Quebec does not have the right to introduce a minimum price for social policy reasons. However, the province does have the right under paragraph 2 of the MOU which reserves the right to introduce measures, including minimum prices, which are consistent with our obligations under the GATT. It is inconceivable that the US should take the position that they can decide unilaterally which of the Canadian provinces have the right to introduce minimum price."

> Washington lobbyist than it was St. Louis. So, all of this is to say that an intervention by these players at this time was not going to kill the MOU.[582]

However, US domestic politics demanded that officials in Washington be seen to act to answer their brewer's concerns. To that end, the USTR requested consultations with Canada on the Quebec minimum price rules.

Following a short and uneventful series of discussions, an agreement to add an annex to the MOU covering Quebec and BC practices was announced by USTR Kantor and the new Liberal Federal Trade Minister, Roy MacLaren on 5 May 1994. Minister MacLaren's news release described the deal as follows:

> Through the consultations, Canada and the United States have come to an agreement on the terms of access for US beer sold in the Quebec market. Under these terms, access will be provided to more than 12,000 points of sale, including convenience and corner stores, where most beer is sold in Quebec. A new annex to the MOU sets out specific understandings related to such issues as transportation and distribution of US beer.[583]

In order to allow the US to further placate its domestic stakeholders, Canada also agreed to review dumping duties in British Columbia being charged against the products of Heileman because of an earlier Canadian trade action.[584] Heileman had raised this issue at USTR, which in turn had brought the matter before the GATT. With the announcement of 5 May 1994 deal, Canada directed the Canadian International Trade Tribunal (CITT) to review the duties under Section 76 of the Special Import Measures Act.[585] Following a perfunctory assessment, the CITT rescinded the duties.[586]

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[582] Dissertation interview.

[583] DFAIT news release. 'McLaren announces conclusion of consultations under the Canada-United States Memorandum of Understanding on Beer.' (5 May 1994).

[584] In addition, a news release by USTR Kantor on the deal (USTR news release. "United States and Canada reach agreement on beer market access in Quebec and British Columbia beer antidumping case." May 4, 1994) specified that there might be more to come on the minimum price issue: "The United States and Canada were unable to reach agreement on minimum price requirements for beer in a number of Canadian provinces, including British Columbia, or on Quebec's proposed minimum price requirements. However, Canada has agreed to future consultations on the minimum pricing issue aimed at finding a mutually acceptable solution. 'The United States does not accept that the practice of setting high minimum prices below which beer cannot be sold, a practice employed by a number of Canadian provinces and that has been proposed in Quebec, is consistent with Canada's GATT obligations," said Ambassador Kantor. "We have therefore reserved all our rights, and agreed to revisit the issue in the future', he added." At the time of writing, the US has not sought to enter consultations with Canada on this issue.

[585] In a letter to USTR Kantor on 29 April 1994, Minister McLaren committed the following on the dumping matter: "I can also confirm that may colleague, the Minister of Finance, will request the Canadian International Trade Tribunal (CITT) to undertake a review, under Section 76 of the Special

With this final act, the Canada-US beer wars came to a close.

Analysis

The events covered in Chapter 8 demonstrate the strengths and the limitations of both the statist and epistemic community approaches. Clearly, the strength of the one perspective is the limitation of the other. That is why the epistemic community approach is a useful addition to statist analysis. It helps to complete statist explanations by highlighting important factors that are usually occluded by analysis focused primarily on rational calculations about maximizing power utilities.

In addition, Chapter 8 serves to underscore the essential role that political 'space' has on the influence that epistemic communities can exert on foreign-policy decision-making. In the initial negotiation and retaliation phases of the dispute, DFAIT and USTR officials were provided wide latitude by political decision-makers to orchestrate events. However, when it came to actually settling Beer 1, it was the direct intervention of the President and the Prime Minister that forced the MOU to be concluded. Moreover, despite interventions by the US domestic brewers, and the continuing resentment of some USTR officials over Ontario's intransigence, as well as no doubt an abiding view at DFAIT that more needed to be done to reform provincial liquor board regulations, the settlement endured, and in fact continues today.

The negotiation and retaliation phases of the post-Panel Report period of the dispute demonstrate the explanatory power of the epistemic community approach. While Canadian and US political officials were involved inasmuch as they endorsed the recommendations of officials and defend publicly the steps that were taken, it was bureaucratic officials at DFAIT and USTR that were determining for the most part the course of events.

The evidence for this assertion is that the track the dispute followed was consistent with the shared views of officials at DFAIT and the USTR about the need for provincial liquor boards to dismantle their protectionist regulatory regimes. There was also an understanding that the US could push Canada more or less as hard as it wanted to – i.e. retaliation against Ontario without securing the approval of GATT

Import Measures Act, of the 1991 decision of the CITT concerning imposition of the anti-dumping duties on certain US beer imported into the province of British Columbia. In his request, my colleague will raise the issues of the existence of a regional industry and a concentration of imports (should a regional industry be found to exist), and whether revocation of the order is likely to result in injury. Such a review by the CITT under Section 76 will constitute a mutually satisfactory solution to the GATT dispute arising from the October 1991 decision of the CITT. The parties will notify the Chairman of the GATT Panel on "Canada-Anti-Dumping Duties on Imports of Beer from the United States" accordingly."

[586] Much to the chagrin of the Canadian industry. However, as in the US, Canadian trade officials had by this point determined that enough time and energy had been expended on the brewing industry and protests were ignored.

Council – as long as nothing vital to the Canada-US relationship was threatened. This understanding extended to Canada's counter-retaliation effort as well. While Canada could have used its counterstrike to signal displeasure at the US retaliation by, for example, targeting products outside of beer, it chose instead to tailor the action to capture only the products of Stroh and Heileman being sold in Ontario.

This latter point is consistent with a further shared view that the dispute must be kept far away from any of the vital components of the Canada-US bilateral relationship. Despite the fact that Canada's brewers might have fared better under CUSTA dispute settlement, or in arbitration, or in the NAFTA talks than in bilateral negotiations with the US, officials at DFAIT and the USTR resisted all attempts to shunt the Canada-US beer dispute into any one of these fora. Instead, the dispute was isolated in bilateral negotiations where it could be kept from spiraling out of control, and also where it could deliver the significant changes to the regulatory regimes of the provincial liquor boards that officials from both DFAIT and the USTR desired.

Evidence is presented in Chapter 8 that the DFAIT-USTR epistemic community would have continued its carriage of the dispute, likely to a much different conclusion than the one that occurred. USTR Mickey Kantor had decided that retaliation against Canada was to be escalated to force additional concessions from Ontario in the negotiations. There was no reason for USTR Kantor to fear that the dispute would escalate out of control if he proceeded down this path. As before, Canada would undoubtedly respond with proportional counter-retaliation. Moreover, Canada's DFAIT officials would likely welcome the initiative as it provided them with further leverage to force concessions from Ontario and Canada's brewers.

What transformed the ability of the DFAIT-USTR epistemic community to continue to influence events was a change in the political players in Canada and the US. Whereas senior political officials in the regimes of Prime Minister Mulroney and President Bush had been content to allow the dispute to be managed for the most part at the departmental level, the coming to power of President Clinton and Prime Minister Campbell, and the immediate political concerns of the latter, broke the control of the epistemic community over events. As noted in Chapter 8, Prime Minister Campbell was concerned about the potential impact that the continuing dispute could have on her electoral prospects. Consequently, she requested that the President intervene to settle the dispute, which he subsequently did.

Prime Minister Campbell's reasons for wanting to settle are clear. President Clinton's are less evident. If the facts of the dispute were the primary motivation for him to instruct USTR Kantor to settle, then one would be hard pressed to understand why he would choose to. It was clear that the Canadian government was unsympathetic to the concerns of both Ontario and Canada's brewers. Moreover, the Beer 1 Panel Report provided much more latitude to force change on Canada than had been extracted to that point via bilateral negotiations. While the Panel Report was clear that having provincial liquor boards in place to administer the importation and regulation of alcoholic beverages was consistent with Canada's international trade obligations, virtually everything else, from the environmental levy to minimum price, was vulnerable. Why then would President Clinton choose to walk away?

While the record is not clear on what President Clinton considered in acceding to Prime Minister Campbell's request, speculation leads to some plausible explanations. First, the United States, Mexico and Canada were locked in a very sensitive stage of negotiations on NAFTA. The President likely understood that an escalation of the beer dispute – even though it represented only a tiny amount of the total trade between the negotiating parties – would not be helpful. He also likely knew that Prime Minister Campbell was in a politically precarious position in the upcoming Canadian election. In fact, she would go on to lose in one of the greatest landslides in Canadian history. Knowing that Canada's Progressive-Conservative Party had a history of favouring positive relations with the United States, and moreover that Jean Chretien, the leader of Canada's Liberal Party, and Prime Minister Campbell's chief rival, had promised previously to scrap the CUSTA, he may have believed that a continuation of the Campbell government was the best alternative to ensure that NAFTA would succeed. Lastly, the President was well known over the course of his mandate to go to great lengths to please not only the American people, but also the leaders of foreign states. Perhaps it was this personal quality that ultimately led him to honour Prime Minister Campbell's request.

All the above are plausible explanations. Whatever the reason, the decision by the President and the Prime Minister to personally intervene in the dispute released the hold that the epistemic community had on events and led to the settlement of the dispute. Clearly, then, while epistemic communities can have a large influence over state decision-making when they have the 'political space' to do so, political officials ultimately control decision-making when they so choose.

Chapter Nine

Conclusion

The impact of the MOU

The decision of US President Clinton and Canadian Prime Minister Campbell to instruct their bureaucratic officials to enter a MOU to settle the Canada-US beer dispute meant that the impact of the US trade action on the Canadian regulatory environment for alcoholic beverages was far less severe than it might otherwise have been. While the settlement forced the dismantling of most restrictions on inter-provincial shipments,[587] which helped to facilitate the framing in 1995 of the IPB agreement that DFAIT officials had sought as a key strategic goal throughout the beer disputes, it also permitted Canada's brewers to develop more competitive plant infrastructures given that many of the key regulatory pillars that had existed prior to Beer 1 remained intact. For example, minimum price regimes were continued, as were environmental regulations and many taxation and distribution/retailing practices that favoured domestic brewers over their foreign competitors.

The MOU exhausted any political capital that US brewers like Heileman and Stroh, and even Anheuser-Busch, might have had to press the US government to pursue Canada. Once the deal was done, it would prove very difficult to change. The result for Heileman and Stroh was that the financial and domestic marketplace pressures that had originally caused them to lobby the USTR to launch the dispute proved overwhelming. Both companies are now out of business.

While some of their projected profitability was sacrificed,[588] Canada's domestic brewers were delighted with the deal. In fact, one senior Canadian beer company representative interviewed for this dissertation indicated that:

> People had to be ecstatic at what the industry got away with. Canada's brewers were able to evolve their national 'footprints' without having to endure an onslaught by US competition at the same time. We ended up in a better position after the MOU than before it. [589]

This is not to say that the Canadian domestic industry remained static. In 1995, after prolonged pressure by dismayed stockholders, Labatt Breweries was purchased outright by Interbrew, a Belgium-based brewer.

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[587] Impediments remain in place in PEI, New Brunswick, Newfoundland and Nova Scotia. However, Canada's national brewers and US brewers have chosen to this point not to challenge them.

[588] Dissertation interview.

[589] Dissertation interview.

Molson Breweries actually chose to reverse a strategic course that had seen it diversify to mitigate the potential risk that an increased North-South flow of beer could have on its earnings, and shed its non-beer holdings to focus once again on brewing. In addition, Molson chose to buy back shares owned by American brewer Miller and Australian brewer Fosters to again become a 100% Canadian-owned business.

The changing marketplace dynamic of the Canadian brewing sector also allowed new players like Sleeman Breweries – which actually purchased Stroh's brands for Canada when that brewery went out of business – Big Rock Breweries, as well as many others, to thrive without having to endure the devastating full-on competition of US discount brewers.

Lastly, the licensed brands of the US major brewers – including Anheuser-Busch, Miller and Coors – remain today some of the fastest growing beers in what is Canada's thriving import beer sector. Other imports like Corona from Mexico and Heineken from the Netherlands are also experiencing impressive growth.

The Hypotheses

There were three hypotheses employed in this examination. The statist hypothesis was tested first, and to reiterate, it was that the events of the Canada-US beer dispute could be explained primarily by considering rational calculations about the material interests at stake in the beer dispute for Canada and the United States.

The rationale for testing the statist hypothesis first is twofold. First, as Goldstein and Keohane advise, to isolate ideas as essential determinants of foreign policy decision-making requires first that analysts 'take seriously' the possibility that outcomes observed can be explained by assessing the material interests at stake for the actors. The second reason is that the primary focus of this analysis is not to replace the statist hypothesis, but rather to supplement it. The view advanced here is that the statist perspective on Canadian foreign policy is a useful take on foreign policy decision-making. However, it does have a number of notable weaknesses. One of these is that it cannot consider individuals and ideas as essential determinants of foreign policy decision-making. Consequently, the explanations that statist analysis provides for events are noticeably incomplete.

To help fill-in the picture, it was necessary to supplement statist analysis with other approaches. As it is the judgment of this study that individuals and ideas have an essential role to play in foreign policy decision-making, it is necessary to deploy an approach that is sensitive to these variables. The epistemic community approach was judged appropriate for this task.

To test the suitability of the epistemic community approach to illuminate what may have been occluded by statist analysis, two hypotheses were examined. They are:

1. An epistemic community comprised of trade officials from Canada's Department of Foreign Affairs and International Trade and the United States Trade Representative's Office was operating during the Canada-US beer disputes; and
2. This epistemic community had a determinative impact on policy outcomes in the Canada-US beer disputes.

Testing the hypotheses

As noted in the analyses appended at the close of each of the case study chapters, the statist explanation provides a compelling explanation of much of what occurred during the Canada-US beer dispute. It is particularly well suited to explaining what started the dispute, and how it ended.

The evidence presented is clear that both the EC and the United States sought dispute settlement against Canada because of lobbying pressure exerted by their domestic industries. Moreover, there was little cost to either the US or the EC pressing the dispute on Canada. There was much for European and United States vintners, distillers and brewers to gain by securing enhanced access to the Canadian market, and there was little for either the EC or the US to lose by referring the dispute to the GATT.

Canada's response at this time also fits a statist explanation. The US and the EC were attacking Canadian industry, and there was a need for Ottawa to mount a defence or face at least some domestic political criticism for failing to act. However, given the size of the domestic alcohol industry in Canada as compared to the potential impact of having EC and US markets denied to much larger Canadian sectors like agriculture and softwood lumber, Canada had to mount a proportional response. By agreeing to participate in a Panel process and then to implement the terms of the Panel report, this is precisely what Ottawa did.

The framing of the MOU to end the dispute also fits a statist explanation of events. Both President Clinton, but especially Prime Minister Campbell, had political reasons to settle the dispute. Consequently, after a Group of Seven summit meeting in Tokyo, each directed their respective trade bureaucrats to bring the dispute to a close. Again, as described in the analysis that ends Chapter eight, this would seem consistent with a statist explanation of events.

While both the beginning and the end of the dispute seem amenable to a statist explanation, there was a great deal that went on in between that does not square with rational calculations of the expected utilities at stake for Canada and the United States. For example, as noted throughout the case study, the post-CUSTA environment was a very sensitive one for the Canada-US bilateral relationship – particularly for Canada. Yet, the United States continued to press Canada aggressively to try to secure market access for two relatively minor US brewers, one of which was owned by an Australian company. Why?

The answer offered in this study is that trade officials at DFAIT in Canada and the Office of the USTR in Washington were operating as an epistemic community - an identifiable group of experts that shared a set of ideas and beliefs and leveraged its expert status and its access to the policy process to influence foreign policy decision-making.

The nature of the shared understanding between DFAIT and USTR officials featured the following elements:

- Open borders to trade were preferable to either protectionism or managed trade.
- Canadian trade barriers – both international and interprovincial - shielded non-competitive industries. These trade barriers must be dismantled to permit the Canadian industrial economy to become competitive internationally.
- The Canadian brewing industry could not adjust to become competitive as it was both protected and impeded by the regulations of the provincial liquor boards.
- Provincial liquor board regulations were largely inconsistent with Canada's international trade obligations. Two GATT Panels confirmed this.
- Canada's brewers had used political influence to avoid inclusion in the CUSTA. The GATT Panel process was only fulfilling what should have been achieved in that agreement.
- The dispute was to be kept far away from CUSTA dispute settlement. A bilateral negotiation was the preferred forum.
- Pressure would be exerted only on the beer sector. Keeping retaliatory actions focused on beer mitigated the risk of uncontrolled escalation.

There were undoubtedly additional understandings that DFAIT and USTR trade negotiators shared about the beer dispute that can be gleaned from the evidence presented in the case study. However, these particular viewpoints are shown by this dissertation to have had a determinative impact on the events of the Canada-US clash on beer.

Before discussing some of the specific evidence that demonstrates the impact of the DFAIT-USTR epistemic community on events in the Canada-US beer dispute, it is important to touch on a further insight developed in this study. It is that an essential enabler for the influence of the DFAIT-USTR epistemic community was the amount of 'political space' that elected officials provided it to operate. At the times when there was little involvement by political officials in the dispute, the epistemic community managed the process for the most part on its own. However, if political officials chose to become involved, for example, the intervention of the President and Prime Minister to end the dispute, then the influence of the epistemic community was diminished substantially.

The influence of the DFAIT-USTR epistemic community is evident in a number of instances throughout the dispute. While examples are interspersed throughout the case study, a few prominent instances merit mention. They are:

- The willingness of the USTR to continue to push Canada aggressively throughout the dispute. USTR officials could do so because they understood that DFAIT officials were unlikely to recommend that Canada respond aggressively. Moreover, they may in fact have welcomed the attack to help manage the IPB negotiations. Moreover, USTR officials knew that attacking Canada aggressively at the GATT was unlikely to sour relations either in the NAFTA discussions or on other more important trade files because DFAIT would not be willing to risk anything of consequence to defend the Canadian brewing industry.
- The reluctance of Canada to press the US on alternative fora to settle the dispute. Despite the BAC offering a number of imaginative methods for the dispute to be arbitrated, DFAIT did little to prevent it from being shunted into the USTR's preferred forum – bilateral negotiations. This was despite the fact that it was widely known that Canada would be least likely to secure a positive outcome for its brewing industry in bilateral talks.
- The carefully calibrated retaliation/counter-retaliation between Canada and the US designed to ensure that nothing of consequence would be put at risk for either country in the exchange.
- Canada's willingness to simply accept as a matter of course the USTR retaliating against Canadian brewers after the US failed to secure GATT approval. As Canada is the largest trading partner of the US, and the value of the trade at stake was important to both partners, Ottawa could have pushed back. This may have ended the beer dispute as there was little at stake for the US to continue to press on beer. But, Canada chose not to respond beyond authorizing the carefully limited counter-retaliatory action that was taken.

There are many other examples of how the DFAIT-USTR epistemic community operated to influence the course of the Canada-US beer dispute presented throughout the case study and reviewed in the analysis sections that conclude each of the case study chapters.

However, the list above provides ample evidence that the epistemic community approach provides at least a valuable supplement to the explanation of events contemplated by the statist theoretical position.

Original Contribution

This analysis provides an original contribution to the literature in four respects. First, little has been written about the Canada-US beer disputes beyond newspaper articles reporting on specific events as they occurred. That this dissertation seeks to present a reasonably comprehensive review of the beer dispute from beginning to end, and also place it within the context of an historical examination of the Canadian and US beer industries as well as the regulatory regimes governing the alcohol sector in both countries, represents a step forward in the literature on this subject.

Second, this examination is an original contribution to the literature in terms of the sources that are utilized. Much of the primary documentation that is so essential to telling the story of the beer disputes has been unavailable as it is a private collection held by the Brewers Association of Canada. Moreover, most of the interview subjects whose stories are featured in this dissertation have never been contacted to discuss the role that they played in the dispute. These sources were invaluable in creating the case study presented in this dissertation.

Third, the paucity of consciously theoretical literature in the field of Canadian foreign policy is described in the first chapter of this dissertation. As noted there, virtually any analysis that purports to examine an issue in Canadian foreign policy by employing theory represents an original contribution to the literature.

Fourth, and last, the literature on epistemic community is still relatively undeveloped. While there have been scholarly articles and a very few more comprehensive examinations published, further development of the concept requires that the epistemic community concept be employed against a wider variety of cases. This dissertation contributes in this regard.

Prospects for Future Research

There are clearly a number of areas in which this research could be expanded. However, there is one particular avenue of enquiry that could prove extremely beneficial to students of International Relations and Canadian Foreign Policy. The number and intensity of trade disputes between Canada and the United States seems to be growing on a daily basis. As a result of the frenetic pace of this activity, an historical record is being developed on a whole array of commodities under dispute, including softwood lumber, salmon, telecommunications, pork, and many others. Using this study as a point of departure in terms of method and approach, an epistemic communities framework could be deployed as a promising theoretical and conceptual framework within which to examine each of these disputes. The results of each case could then be compared to the conclusions of this dissertation to further improve our understanding of how epistemic communities operate in influencing foreign policy decision-making and how the statist perspective can be supplemented to provide a more accurate picture of the way in which foreign policy is formulated..

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